FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMPENSATION AND EMPLOYEE BENEFITS

OF THE

COMMITTEE ON POST OFFICE AND CIVIL SERVICE HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

H.R. 2514

A BILL AMENDING SUBCHAPTER III OF CHAPTER 84 OF TITLE 5, UNITED STATES CODE

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FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

TUESDAY, JULY 25, 1989

HOUSE OF REPRESENTATIVES,
COMMITTEE ON POST OFFICE AND CIVIL SERVICE,
SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS,
Washington, DC.

The subcommittee met, pursuant to notice at 10:43 a.m., in room 311, Cannon House Office Building, Hon. Gary L. Ackerman (chairman of the subcommittee) presiding.

Mr. ACKERMAN. The subcommittee will come to order. Today the Subcommittee on Compensation and Employee Benefits will conduct an oversight hearing of the Federal Thrift Investment Board and discuss H.R. 2514, a bill to amend the Thrift Savings Plan portion of the Federal Employees Retirement System. The Thrift Savings Plan currently has 1.4 million accounts with $3.9 billion available for investment. The TSP grows at a rate of $8 million every business day.

Employees covered by FERS may contribute up to 10 percent of their salary to the TSP and the government will match up to 5 percent. CSRS employees may contribute up to 5 percent of salary to the plan. All employee contributions are tax-deferred.

The Thrift Savings Plan is made up of three investment funds: the Government Securities Fund, or the G Fund, the Fixed Income Fund, the F Fund, and the Common Stock, or C Fund. FERS employees have their choice of investing in any or all of the funds, while CSRS employees are limited to the G Fund only. I think all the Committee members will agree that the TSP presents an excellent investment opportunity for Federal employees and every indication is that the Thrift Board has done a tremendous job in administering the plan.

H.R. 2514, which we will also discuss today, makes technical changes to the Thrift Savings Plan which will benefit Federal employees and make the plan easier for the board to administer. I am pleased to have introduced this bill with my good friend, Representative Ben Gilman, also a member from New York.

H.R. 2514 would authorize Federal agencies to pay lost earnings to employees' Thrift Savings Accounts caused by administrative errors of employing agencies. While errors of this type are not frequent, undetected errors could have a drastic effect on the retirement benefits of individual employees.

The bill would also remove the limitations which present law places on the allocations which FERS employees may make to

either the C or the F Fund. The restrictions were originally included to limit potential budgetary impact. Since the enactment of FERS, however, the GAO has ruled that the plan's transactions should not be included in the Federal budget, therefore the restrictions are no longer needed.

Removing the restrictions would benefit employees by reducing confusion concerning the amount of contributions and earnings which may be placed in the C or F Funds and by allowing participants to more easily allocate their contributions among the three.

Today we will hear from the Federal Retirement Thrift Investment Board, the Employee Thrift Advisory Council, the Pension and Welfare Benefits Administration and the General Accounting Office. But before that of course we will hear from the distinguished gentlewoman, Mrs. Morella.

[The prepared statement by Mrs. Morella follows:]

STATEMENT OF HON. CONSTANCE A. MORELLA

Mr. Chairman, I am pleased to make a few comments about the Thrift Savings Plan and H.R. 2514 this morning.

I am heartened that the Thrift Board has put in place a plan as large as the Thrift Savings Plan in just two and a half years since the first investments on April 1, 1987. I am sure that Francis Cavanaugh, Executive Director of the Board, will comment on the growth of the TSP, but I do want to congratulate him and his staff for their untiring endeavors in making the Thrift Savings Plan—the largest retirement plan in the country—a plan which is catching on among Federal employees.

Mr. Chairman, there certainly are a few problems with the system and my constituents make me very aware of them. I want to share with you that whenever such problems occur, and I contact the Board, they have been expeditious and responsive. However, in the case of lost earnings when there is a snafu on the agency level, the Board's hands were tied, and there was no recourse to reimburse the employee. I congratulate you, Mr. Chairman, and the ranking member of the committee, Mr. Gilman, for introducing H.R. 2514 which, among other provisions, will give authority for the Executive Director to prescribe regulations requiring agencies to pay to the Thrift Savings Fund monies necessary to correct agency errors when forwarding employee funds to the TSP. This will make agencies more careful, and make the employee whole retroactively. This measure will also increase the faith of employees in the plan and encourage more participation.

I am heartened that there are more options available to Federal employees, both in the Civil Service Retirement System [CSRS] and the Federal Employee' Retirement System [FERS]. I am sure that under the guidance of Mr. Cavanaugh, a career Federal employee, we will have a model plan.

I look forward to swift passage of H.R. 2514.

Ms. MORELLA. I thank you, Mr. Chairman, for having this hearing. I associate myself with the remarks you have made on listening to the witnesses. I am pleased to learn that the first plan is working so well and that the Board has been established and oversight seems to be in order. I look forward to specifically learning and having an opportunity to question the witnesses on the operation of this very important plan.

Thank you, Mr. Chairman.

Mr. ACKERMAN. Thank you very much. Our first witness will be Mr. Francis X. Cavanaugh, the Executive Director of the Federal Retirement Thrift Investment Board.

Mr. Cavanaugh, welcome to our subcommittee. Make yourself comfortable and you may proceed as you choose.

STATEMENT OF FRANCIS X. CAVANAUGH, EXECUTIVE DIRECTOR, FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

Mr. CAVANAUGH. Thank you, Mr. Chairman. I have a lengthy prepared statement that I would request be included in the record.

Mr. ACKERMAN. Without objection, your entire statement will be included as part of the official record.

Mr. CAVANAUGH. Thank you, I will proceed with a brief summary of my statement.

I welcome this opportunity to report to you on the implementation of the Thrift Savings Plan for Federal employees. Today, all investment, loan and other programs of the plan as envisioned by Congress in the Federal Employees' Retirement System Act of 1986 are in place.

The Board has established approximately 1.4 million individual participant accounts, making it the largest such plan in the Nation. Plan investments have grown to over $3.9 billion and are growing by over $8 million each business day.

My prepared statement for the record explains the structure of the Thrift Savings Plan and its administration by the Board in cooperation with other Federal agencies with statutory responsibilities for the plan under the 1986 act.

The 1986 act provides that all moneys in the Thrift Savings Fund are held in trust for the benefit of the participants and beneficiaries. As fiduciaries, the Board members and the executive director are required by the statute to act prudently and solely in the interests of plan participants and beneficiaries.

This fiduciary responsibility gives the Board a unique status among United States Government agencies. Congress wisely established this fiduciary structure because it recognized that all funds held in trust by the plan belonged to the participants, not the government, and thus must be managed solely for them, independent of political, social or other considerations.

Accordingly, Congress exempted the Board from the normal budget/appropriations process and the legislative and budget clearance process of the Office of Management and Budget. This independence is critical to ensure the fiduciary accountability envisioned by FERSA, the 1986 act, and to assure Federal employees that their voluntary savings will not be subject to political or other priorities which might otherwise be imposed by the usual budget/appropriations process.

There were many organizational challenges in the Board's first year of operation, as we established the identity of this unique Federal agency and gradually developed a mutual understanding of the intent of Congress and FERSA with respect to the division of responsibilities among Federal employing agencies, the General Accounting Office, the Department of Labor, the Office of Personnel Management, the members of the Board and the Executive Director.

I am pleased to report that the roles of all of these responsible parties are now well-established and that the working relationships among them are excellent. There is a common sense of purpose, cooperation and enthusiasm which I find both remarkable and most reassuring with respect to our future operations.

The Employee Thrift Advisory Council has been especially helpful in providing the Board with insights into employee needs, attitudes and reactions to the various programs undertaken by the Board.

The Board has also benefited greatly from audit reports over the past two years which have covered every aspect of the plan. Attached to my prepared statement is a list of 18 audit reports on the Thrift Savings Plan by GAO and by four of the "big eight" accounting firms. These reports have been very positive and have reassured me that the plan is working well.

The Board is particularly pleased that the Department of Labor has commissioned such a comprehensive audit program by its contractors, Price Waterhouse and Peat Marwick. The Board will continue to work closely with the agencies, the employee groups and the oversight committees of the Congress to maintain the communications and consensus essential to the continued success of the Thrift Savings Plan.

The successful implementation of the Thrift Savings Plan is a tribute, in particular, to the extraordinary efforts of the Federal personnel, payroll and other administrative employees throughout the world.

The employing agencies are responsible for employee counseling, plan enrolments, and for the accurate and timely transmission of participant and employer contributions to our recordkeeper, the National Finance Center in New Orleans.

The National Finance Center has also done an outstanding job in servicing participants in the plan. It handles over 10,000 participant inquiries each month. In addition, NFC has processed over 60,000 withdrawals to separated employees, although the plan is only two years old, and it has disbursed almost 13,000 loans to date.

Ninety-six separated participants have purchased plan annuities from our contractor, the Metropolitan Life Insurance Company.

The production and dissemination of informational materials and forms to Federal employees has been a major and growing Board activity since the inception of the plan.

Thus far, we have distributed almost 25 million open season information booklets, pamphlets, flyers and posters and over 25 million forms to Federal employees throughout the world.

We believe our information materials have been well-received. While we will not know the results of the current open season until next month, approximately 50 percent of eligible FERS employees have thus far elected to contribute to the Thrift Savings Plan. This participation rate compares very favorably with the experience of other, similar, large private plans.

Consistent with our fiduciary responsibility to act solely in the interests of the plan's participants and beneficiaries, we do not attempt to sell the plan to Federal employees. Our purpose is to educate employees, pointing out the risks as well as the rewards, so that they may understand fully the plan benefits available to them and make an informed decision concerning their participation in the plan. Federal employees must be assured that it is their plan, their money, and that our sole purpose is to serve their interests.

Turning now to our investment funds, the 1986 act established the Government Securities Investment Fund, what we call the G Fund, as the initial investment vehicle for the Thrift Savings Plan. The G Fund is invested entirely in short-term securities, thus avoiding the risk of fluctuations in the value of the securities as market interest rates change.

The G Fund is managed by the staff of the Board working directly with the Treasury Department, which is the statutory custodian of the G Fund as well as the issuer of the securities. The G Fund is the only investment fund available to CSRS employees, and it was the only investment fund for FERS employees in 1987.

FERSA provides that beginning in January 1988 FERS employees could invest a portion—up to 20 percent—of their contributions in the other two funds, the Common Stock Index Investment Fund, which is called the C Fund, and the Fixed Income Index Investment Fund, which is called the F Fund. Over the next four years, from 1989 to 1992, an additional 20 percent each year of employee contributions could be invested in the C and F Funds until all employee contributions are unrestricted.

Then, from 1993 through 1997, participants would similarly be permitted to begin and increase gradually their investments of employer contributions in the C and F Funds.

In part because of the statutory investment restrictions, nearly all plan investments are now in the G Fund. Of the total of $3.9 billion plan investments, $3.8 billion is in the G Fund, $27 million is in the C Fund and $11 million is in the F Fund. Yet the C and F Funds are becoming increasingly popular.

Of the 421,000 FERS employees who have contributed their own money to the plan and are thus eligible to invest in these funds, about 93,000, or 22 percent, have already elected to invest in the C and/or F Funds.

The Board selected the Standard & Poor's 500 Stock Index, the so-called S&P 500, as a basis for the C Fund, and the Shearson Lehman Hutton Government/Corporate Bond Index as a basis for the F Fund. The Board contracted with Wells Fargo Bank to manage both the C and the F Funds.

The broad composition of the C and F Funds in conjunction with the G Fund provides employees with the opportunity to diversify their portfolios into a broad range of (1) risk-free short term instruments in the G Fund; (2) equities in the C Fund; and (3) intermediate and long-term debt securities in the F Fund.

For the 12-month period ending June 30, 1989, the net investment returns for participants were 9.18 percent for the G Fund, 20.85 percent for the C Fund, and 12.09 percent for the F Fund. These returns were after deducting net plan administrative expenses of approximately .28 percent. That is, the net reduction in investment returns to participants was approximately $2.80 for each $1,000 of their account balance.

This expense ratio is expected to decline as the plan continues to grow. In the calendar year 1988, this expense ratio was .34 percent, and in the calendar year 1989 it is expected to decline to approximately .25 percent.

Thrift Savings Plan expenses paid by participants are low primarily for three reasons: first, the enabling legislation provides

that the 1-percent agency automatic contributions to FERS employees who then leave government service prior to vesting are to be forfeited and used to defray plan administrative expenses.

Second, the Federal agencies provide many of the services to active employees that otherwise be done at a cost to the plan.

Third, the Board as a Federal agency operating the largest employee savings plan in the Nation, is in an unusually strong position to procure investment and other services at relatively low cost to participants in the plan.

I will now turn to the Board's proposed legislation, which was submitted to the Congress on April 12, 1989. The bill was introduced in the House as H.R. 2514, on May 31——

Mr. ACKERMAN. Mr. Cavanaugh, excuse me, before you resume with the Board's proposal. We are in the process of a vote, and I think this might be a place that we could take a break for a minute. We will run over and vote and return to you because we want to spend a bit of time with you and not rush you, if that is okay.

Mr. CAVANAUGH. Fine. Thank you, Mr. Chairman.

Mr. ACKERMAN. In that case, is that okay, Ms. Morella?

Ms. MORELLA. Yes.

Mr. ACKERMAN. We will in that case recess and resume as quickly as we can get back here. The Committee stands in recess.

[Whereupon, the hearing recessed for a vote at 11 a.m.]

Mr. ACKERMAN. The subcommittee will come to order. We will resume where we left off. There are additional votes that are expected. I think we should have close to a half hour before the next one. That should give us ample time to proceed for a while. Mr. Cavanaugh, thank you very much, you may continue.

Mr. CAVANAUGH. Thank you Mr. Chairman. I will turn now to the Board's proposed legislation which was submitted to the Congress on April 12, 1989. The bill was introduced in the House as H.R. 2514 on May 31, 1989 and we are grateful, Mr. Chairman, for your prompt introduction of this legislation, and for the consideration you are giving it at these hearings.

Our legislative proposal is explained in detail in the material submitted to Congress in April 1989 and is summarized in the statement I submitted for the record today. Briefly, the bill would authorize payments by employing agencies to the Thrift Savings Fund of lost earnings resulting from employing agency errors.

In 1987 the Board issued regulations permitting the employing agencies to make such payments to their employees' accounts in the Thrift Savings Fund if they have the authority to do so. However, the agencies have found that they generally do not have sufficient statutory authority to make such payments, as indicated in a February 1989 ruling by the Comptroller General.

The draft bill would also expedite the removal of restrictions on FERS participants' investments in the C&F Funds. As I mentioned earlier these restrictions require that specified portions of contributions must remain invested in the G Fund over a 10 year period. Under current law, the investment fund restrictions on employee contributions are phased out in 20 percent increments over the first five years of the plan, while the restrictions on agency contri-

butions are similarly phased out over the next five years of the plan.

As indicated in my statement, these restrictions were apparently intended to reduce federal budget outlays, since the G Fund was expected to be treated as an on-budget fund. Yet Congress adopted a change in budget treatment of the G Fund in 1988 so that the restrictions no longer serve this budget purpose. Yet the restrictions are costly to administer and difficult for federal employees to understand.

The Employee Thrift Advisory Council, which includes representatives of the organizations representing federal and postal employees, has recommended that the Board initiate legislative proposals to accomplish the purposes of H.R. 2514.

Mr. Chairman, that concludes my prepared statement. The Board looks forward to working closely with your subcommittee so we may best achieve our mutual goal of ensuring that the plan will be, both in design and operation, the exemplary program that the Congress envisioned. We will continue to make every effort to maintain the enthusiasm, confidence and trust which have characterized our initial efforts. I would be happy to answer any questions.

[The prepared statement of Mr. Cavanaugh and a subsequent letter responding to written questions follow:]

FOR RELEASE ON DELIVERY
Expected at 10:30 a.m. EDT
July 25, 1989

STATEMENT BY FRANCIS X. CAVANAUGH
EXECUTIVE DIRECTOR
FEDERAL RETIREMENT THRIFT INVESTMENT BOARD
BEFORE THE
SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS
OF THE
HOUSE COMMITTEE ON POST OFFICE AND CIVIL SERVICE

Mr. Chairman and Members of the Subcommittee:

I welcome this opportunity to report to you on implementation of the Thrift Savings Plan for Federal employees.

The Thrift Savings Plan is a retirement savings plan similar to private-sector plans under Section 401(k) of the Internal Revenue Code. TSP participants make voluntary contributions (via payroll deduction). Like many private-sector plans, participants in the new Federal Employees' Retirement System also receive contributions from their agencies to match a portion of their voluntary contributions. Contributions are not taxed until distributed from the Plan. Also, the Thrift Savings Plan has a loan program similar to those that are becoming more popular in the private sector subsequent to the Tax Reform Act of 1986.

Today all the programs of the Plan, as envisioned by Congress in the Federal Employees' Retirement System Act of 1986 (FERSA), are in place. The Board has established

approximately 1.4 million individual participant accounts, making it the largest such plan in the Nation. Plan investments have grown to approximately $3.9 billion and are growing by over $8 million each business day. The Plan's three investment Funds are well established: the Government Securities Investment (G) Fund, the Common Stock Index Investment (C) Fund, and the Fixed Income Index Investment (F) Fund. Programs are also fully operational for Plan loans, interfund transfers, annuities and other withdrawal options.

Plan Structure

The Plan is available to employees covered by both the new Federal Employees' Retirement System (FERS) and the old Civil Service Retirement System (CSRS). Other groups, such as judges, are also entitled to Plan benefits. For FERS employees, who are generally employees hired since January 1, 1984, the Plan is one of the three basic components of their retirement package. The other two components are the FERS Basic Annuity and Social Security benefit payments. FERS employees receive an automatic contribution to their Thrift Savings Plan account, paid by their employing agency, which is equal to one percent of their basic pay each pay period. They may elect to contribute up to 10 percent of basic pay each pay period to the Plan, and their employing agency provides matching contributions on the first five percent of basic pay contributed. FERS employees may also invest in each of the

Plan's three investment Funds -- currently on a restricted basis, which will be discussed later in this statement.

For CSRS employees, the Plan may be viewed as an IRA-type supplement to their CSRS benefits. They receive the same tax benefits as FERS employees, but they may contribute only up to five percent of their pay to the Plan each pay period. They receive no automatic or matching contributions from their agencies. Their contributions are invested in the G Fund; they have no other investment options.

When Plan participants leave Federal service, they may transfer their vested account balances to an IRA or other eligible plan. Separating participants who are eligible for retirement under the defined benefit provisions of their retirement system have additional withdrawal options. They may leave their funds in the Plan, have the Plan purchase an annuity for them, or, in the case of participants who have also reached retirement age, receive a lump sum or series of equal payments.

Plan Administration

The Plan is administered by the Federal Retirement Thrift Investment Board, which was established as a Federal agency under FERSA in 1986. The initial Board members were appointed by the President for one-year terms beginning on October 1, 1986. I was appointed by the Board as the first Executive Director effective November 1, 1986. In late 1988, the Senate confirmed the President's five nominees to serve on the Board

for two- to four-year terms. The Board members are appointed from the private sector to serve on a part-time basis. They meet once a month, as required by FERSA, and are responsible for the overall policies of the Plan. The Executive Director is the chief executive officer of the agency and is responsible for the day-to-day management of the Plan.

FERSA provides that all monies in the Thrift Savings Fund are held in trust for the benefit of the participants and beneficiaries. As fiduciaries, the Board members and Executive Director are required by the statute to act prudently and solely in the interest of Plan participants and beneficiaries. This fiduciary responsibility gives the Board a unique status among U.S. Government agencies.

Congress wisely established this fiduciary structure because it recognized that all funds held in trust by the Plan belong to the participants, not the Government, and thus must be managed for them independent of political, social, or other such considerations.

The Conference Report on FERSA, House Report 99-606, dated May 16, 1986, states in the Joint Explanatory Statement of the Committee of Conference at pages 136 and 137:

> "Concerns over the specter of political involvement in the thrift plan management seem to focus on two distinct issues. One, the Board, composed of Presidential appointees, could be susceptible to pressure from an Administration. Two, the Congress might be tempted to

use the large pool of thrift money for political purposes. Neither case would be likely to occur given present legal and constitutional restraints."

"As to the issue of Congress tampering with the thrift funds, the inherent nature of a thrift plan precludes that possibility. Unlike a defined benefit plan where an employer essentially promises a certain benefit, a thrift plan is an employee savings plan. In other words, the employees own the money. The money, in essence, is held in trust for the employee and managed and invested on the employee's behalf until the employee is eligible to receive it. This arrangement confers upon the employee property and other legal rights to the contributions and their earnings. Whether the money is invested in Government or private securities is immaterial with respect to employee ownership. The employee owns it, and it cannot be tampered with by any entity including Congress."

In keeping with the intent of Congress that the Plan be administered in accordance with fiduciary standards derived from those applicable to private sector employee benefit plans -- as distinct from the usual administration of an Executive Branch agency -- the Congress exempted the Board from the normal budget-appropriations process and the legislative and budget clearance process of the Office of Management and Budget. This independence is critical to ensure the fiduciary

accountability envisioned by FERSA. So long as the Plan is managed by the six fiduciaries named in FERSA (the five members of the Board and the Executive Director) in accordance with the statute's strict fiduciary standards, Federal employees can be confident that their voluntary savings will not be subject to political or other priorities which might otherwise be imposed by the usual budget-appropriations process.

Congress reaffirmed its commitment to exempt Board actions from normal budgetary controls in 1987 by explicitly exempting the Board and the Thrift Savings Fund from sequestration under the Gramm-Rudman-Hollings Balanced Budget and Emergency Deficit Control Act. In addition, Congress rejected an Administration proposal in 1988 to limit the administrative expenditures of the Fund. Because of these supportive actions by Congress, Federal employees can be more confident that their interests will be protected and their funds managed to their best advantage.

Although the Board is independent by statute, it is subject to continuing audit and review under FERSA. FERSA protects the Fund through more than just the fiduciary responsibilities of the Board members and the Executive Director. Additional safeguards to protect Plan participants include the provisions in FERSA relating to (1) the role of the Secretary of Labor in establishing a program of fiduciary compliance audits, (2) the requirement that the Board contract with a private accounting firm to conduct an

annual audit of the Plan on the basis of Generally Accepted Accounting Principles, (3) the role of the General Accounting Office regarding agency contributions to the Plan, and (4) the advisory role of the 14-member Employee Thrift Advisory Council, which represents the major Federal employee unions and other employee organizations.

The Board has benefitted greatly from audit reports over the past two years which have covered every aspect of the Plan. These include two reports to Congress by the General Accounting Office, reports by the accounting firms of Arthur Andersen & Co. and Coopers & Lybrand which were commissioned by the Board, and several recent reports to the Department of Labor by their contract auditors, Price Waterhouse and Peat Marwick Main & Co. Attached to my testimony is a list of all of these audit reports, which illustrates the comprehensive nature of the audit programs.

The Employee Thrift Advisory Council meets quarterly with the Executive Director and advises on investment policy and the administration of the Thrift Savings Plan. The Council meetings have also been invaluable in providing the Board with insights into employee needs, attitudes, and reactions to the various programs undertaken by the Board.

The Plan also benefits from the scrutiny of every agency in the Federal establishment. Although the Board is an independent policy-making body, it is completely dependent upon the cooperation of all Federal agencies, which have direct

responsibilities under FERSA for the implementation of the Plan.

There were many organizational challenges in the Board's first year of operation, as we established the identity of this unique Federal agency and gradually developed a mutual understanding of the intent of Congress in FERSA with respect to the division of responsibilities among Federal employing agencies, the General Accounting Office, the Department of Labor, the Office of Personnel Management, the members of the Board and the Executive Director. I am pleased to report that the roles of all of these responsible parties are now well established and that the working relationships among them are excellent. There is a common sense of purpose, cooperation, and enthusiasm which I find both remarkable and most reassuring with respect to our future operations.

The Board will continue to work closely with the Administration, the employee groups, and the oversight committees of the Congress to maintain the communications and consensus essential to the continued success of the Thrift Savings Plan.

Plan Implementation

The successful implementation of the Thrift Savings Plan is a tribute, in particular, to the extraordinary efforts of Federal personnel, payroll, and other administrative employees throughout the world. The 1986 Act required the Board to begin investing Plan funds on April 1, 1987, for approximately

600,000 employees. In just six months, from October through March, while the Board was also in the process of designing and staffing a new Federal agency, a recordkeeping system to maintain each individual employee's Plan account was established; the Government's approximately six hundred payroll offices were identified, and their data processing systems were modified and linked to the Plan's recordkeeper, the Department of Agriculture's National Finance Center (NFC) in New Orleans; and Plan educational materials were developed, printed, and distributed through personnel offices around the world to nearly three million Federal employees.

In order to meet the statutory implementation deadlines of April 1987 for accepting and investing contributions and January 1988 for the establishment of the stock and bond investment funds and the Plan's loan program, the Board adopted a five-phase developmental approach.

Phase I was the development and implementation of the procedures for the computation and transmission of Plan contributions by the agencies and the receipt, control, and investment of these contributions by NFC and the Board. Phase II was the development of Plan subsystems and operational procedures to provide separating participants with annuities and other forms of withdrawal benefits. Phase III included the simultaneous development of the loan program for all participants and the additional investment funds for FERS employees. Phase IV was the development of the Plan's

interfund transfer procedures to enable FERS employees to reinvest their prior Plan contributions among the Plan's investment funds. We are currently in Phase V, which is the post-implementation review and enhancement phase. This process includes a thorough review of all systems operations, the completion of final systems documentation, and the design and development of systems enhancements to operate the Plan effectively in the coming years.

I will now briefly address the major program activities of the Plan -- Recordkeeping, Employee Benefits and Services, Communications, and Investments.

Recordkeeping

Clearly, the establishment of a recordkeeping system was the most fundamental challenge that faced the Board at the start of the Plan. This job has been done in an outstanding manner by our contractor, the National Finance Center. NFC currently maintains over 125 million records for the 1.4 million participants in the Plan. In April and May of 1987, the Plan's contribution subsystem was implemented with the processing of agency transmittals of both current and retroactive contributions; the establishment of the initial data base of approximately 600,000 participants; the beginning of daily investment in the G Fund and the attendant accounting functions; the first monthly allocation of earnings to participant accounts; and the production and mailing of an account statement to each participant.

The initial withdrawal subsystem was then developed. Implementation began at the end of 1987 with the processing of forfeitures and transfer payments to Individual Retirement Accounts. The withdrawal subsystem was completed in early 1988 with the processing of lump sum payments, death benefits, equal payments, and annuities. While the Plan is just over two years old, we have already processed 60,000 withdrawals for separated employees.

Plan capabilities to receive and process loan applications, to disburse loans, and to receive and account for participant investments in the C and F Funds were also developed in early 1988. The final statutory Plan feature, the interfund transfer process, was implemented in July 1988.

During the development of the Plan's recordkeeping capabilities, Board staff met extensively with experts in the private sector. Short-term consultant contracts were used very effectively, and, I am pleased to note, much of the private sector contribution to the development of the Plan was provided at no cost to the Plan.

Employee Benefits and Services

Federal employees who participate or are interested in the Plan are served primarily by the personnel, payroll, and other administrative employees in their own agencies. The agencies are responsible for employee counselling, for Plan enrollments, and for the accurate and timely transmission of participant and employer contributions to our recordkeeper,

the National Finance Center. Also, the Plan's TSP Service Office at the NFC performs a wide variety of services for Plan participants. That office works directly with current employees to provide loan and interfund transfer services, and it functions as a surrogate personnel office -- answering questions and providing interfund transfer and withdrawal program assistance -- to those employees who have left Government service and still have active Plan accounts.

Annuities. During 1987, the Board established policies for Plan annuities, and a Request for Proposals (RFP) was developed to procure the services of an annuity vendor. The competitive procurement resulted in the award of the Plan's Master Annuity Contract to Metropolitan Life Insurance Company in December 1987.

Under the contract, Metropolitan provides the Plan's five basic statutory types of single and joint life annuities, as well as cash refund and 10-year-certain payout options. Thrift Savings Plan annuities compare favorably to annuities of other vendors as described in a recently published competitive ranking of single premium commercial annuity vendors. For the most common annuity option (Joint Life with a 100 percent survivor benefit), the Thrift Savings Plan monthly benefit is 12 percent greater than the average for the 40 most competitive annuity vendors; the monthly Plan benefits of the various single life options are 11 to 24 percent greater.

The minimum amount required to purchase an annuity is

$3,500. To date 96 separated participants have purchased Plan annuities.

Loans. The development of the policies and procedures of the Plan's loan program has been a major effort of the Board over the past two years. When we began to formulate loan policy in 1987, Board staff met with experts in the private sector, who advised that the development of the loan program would be a highly complex undertaking that would normally take several years to complete. Today, each of the four statutory loans -- medical, educational, home purchase, and financial hardship -- is in place.

The loan program conforms to the "benefit" model for such programs -- where loans are made not for "investment" purposes but as an entitlement of the Plan (as long as they conform to the purposes set forth in the statute). Participants borrow from their own contributions and earnings in their accounts. They repay loans, with interest, through payroll deductions deposited directly into their Plan accounts.

The Board's loan program is designed to facilitate prompt and equitable processing of loan applications in a manner that will minimize loan administrative costs, which are borne by all of the Plan's participants. Given the size of the Plan -- approximately 1.4 million current participants and potentially three million or more participants -- it would not have been feasible to adopt the more subjective, labor-intensive and time-consuming approach of establishing loan

committees to evaluate the merit of every application. Instead, the Board devised a system whereby a loan-specific and highly objective set of criteria and documentation requirements were incorporated into the application form for the four loan types available. In this way, loan applications are processed in a timely and objective manner and loan applicants can generally determine for themselves, by the time they complete their application forms, whether their individual circumstances conform to one of the four loan purposes established by statute.

This approach has served the Plan well since we began processing loan applications in January 1988. Currently, we are receiving about 100 loan applications a day, and we are processing those applications within a three-day time frame. If the applicant meets the initial application requirements (for example, the requirement for a minimum loanable account balance of $1,000 in employee contributions and earnings), a loan agreement is sent to the applicant. The completed loan agreement forms must be returned by the applicant within 45 days from the date the loan agreement is produced and the loan terms are established. Loans are disbursed once a month, at the time of our regular mid-month disbursement cycle, and almost 13,000 loans have been made so far.

Communications

The production and dissemination of informational materials and forms to Federal employees has been a major Board activity since the inception of the Plan. For the first two years,

the Board issued an updated information booklet for each semiannual open season. For the current open season, which ends this month, the Board introduced a new "family" of information materials to enhance communication of the benefits of the Plan to Federal employees. These materials include a comprehensive Plan Summary, an Open Season Update pamphlet, and an open season poster.

The Plan Summary is a lengthy document similar to the Summary Plan Descriptions published by private-sector pension plans; it is given to all new employees by their personnel offices and is available to other employees upon request. The Plan Summary is not specific to a given open season and thus will not need to be revised until there are major changes in the Plan. The Open Season Update is a smaller pamphlet that briefly summarizes the Plan and explains how to sign up. The Update is distributed to every Federal employee and will be revised and redistributed each open season. The open season poster was designed to assist agency personnel offices in making employees aware of the open season and to avoid the need for agencies to develop their own posters.

In addition to producing the materials for agency distribution, the Board encloses with each Participant Statement a newsletter, "Highlights of the Thrift Savings Plan," which keeps participants (including those who have left Government service) current on the activities of the Plan and the investment performance of the three Plan Funds.

We have been very pleased with the distribution of Plan materials to Federal employees throughout the world. Employing agencies have generally been very successful in redistributing our materials and making their employees aware of each open season. Groups represented on the Employee Thrift Advisory Council have been very generous in devoting space in their publications to information about the Plan. There has been broad exposure to Plan materials and, we believe the materials have been well received. While we will not know the results of the current open season until next month, approximately 50 percent of eligible FERS employees have thus far elected to contribute to the Thrift Savings Plan. This participation rate compares very favorably with the experience of other similar large private plans.

This summer, the Board plans to conduct a survey on how well the new information materials serve our objective of educating each and every eligible employee about the benefits of the Plan. Consistent with our fiduciary responsibilities to act solely in the interests of the Plan's participants and beneficiaries, we do not attempt to sell the Plan to Federal employees. Our purpose is to educate employees, pointing out the risks as well as the rewards, so that they may understand fully the Plan benefits available to them and make an informed decision concerning their participation in the Plan. Federal employees must be assured that it is their Plan, their money, and that our sole purpose is to serve their interests.

A survey we conducted in the fall of 1987 indicated that some FERS employees were not contributing, and thus were not getting the agency matching payments, because of a lack of understanding. In response, we developed a flyer especially targeted to noncontributing FERS participants, which we mailed to all such participants in May 1988. In the following open season, we were gratified to find that participation increased by about 7 percent in the target group. Similarly, we plan to enclose a special insert for noncontributing FERS employees in our next Participant Statement mailing, which responds to the major reasons FERS participants may give for not contributing their own money to their Plan accounts.

We share the results of our surveys with the heads of all agencies in order to assist them in communicating with their employees about the Plan. Although the Board develops Plan policies, manages Fund investments, provides the recordkeeping, and distributes informational materials to the agencies at the "wholesale" level, it is primarily the thousands of agency personnel and other specialists who work directly with the Federal employees at the "retail" level. It is thus essential that the agencies be kept abreast of the results of their communication efforts.

Other participant materials that the Board has published include booklets describing the loan program, the annuity program, and withdrawal procedures and options, as well as

forms, fact sheets on monthly investment returns, and other information in question and answer format.

Thrift Savings Plan bulletins are issued regularly to inform agency personnel and payroll specialists of current operating procedures. The Board also conducts regular interagency meetings, which have proven to be a highly effective means of communicating program and systems requirements to the user community, and have also provided a means for the Board to address agency concerns and to incorporate agency suggestions in the establishment of Plan policies.

Investment Funds

FERSA established the Government Securities Investment (G) Fund as the initial investment vehicle for the Thrift Savings Plan. The G Fund is the only investment Fund available to CSRS employees, and it was the only investment Fund for FERS employees in 1987. FERSA provides that, beginning in January 1988, FERS employees could invest a portion (up to 20 percent) of their contributions in two other funds: the Common Stock Index Investment (C) Fund and the Fixed Income Index Investment (F) Fund. Over the next four years, from 1989 to 1992, an additional 20 percent each year of employee contributions could be invested in the C and F Funds until all employee contributions are unrestricted. Then, from 1993 through 1997, participants would similarly be permitted to

begin and increase gradually their investments of employer contributions in the C and F Funds.

In part because of these statutory investment restrictions, nearly all Plan investments are now in the G Fund. Of the total of $3.9 billion Plan investments, $3.8 billion is in the G Fund, $27 million is in the C Fund, and $11 million is in the F Fund. Yet the C and F Funds are becoming increasingly popular. Of the 421,000 FERS employees who have contributed their own money to the Plan, and are thus eligible to invest in these Funds, about 93,000, or 22 percent, have already elected to invest in the C and/or F Funds.

The G Fund consists of investments in short-term nonmarketable U.S. Treasury securities specially issued to the Plan. G Fund investments earn interest at a rate that is equal, by law, to the average of market rates of return on U.S. Treasury marketable securities outstanding with four or more years to maturity. This statutory interest rate formula in FERSA is the same as the statutory formula for the investment of the Social Security funds and the Civil Service Retirement Fund. The G Fund is invested entirely in short-term securities, thus avoiding the risk of fluctuations in the value of the securities as market interest rates change. The G Fund is managed by the staff of the Board, working directly with the Treasury Department, which is the statutory custodian of the G Fund.

In June 1987, the Board selected the Standard and Poor's 500 stock index (S&P 500) as the basis for the Common Stock Index Investment (C) Fund. Many factors were considered in the selection of this index, including name recognition, ready availability of many private sector index fund managers, and the fact that the S&P 500 represents 80 separate industries and close to two-thirds of the aggregate market value of the United States equity markets.

In July 1987, the Board adopted a policy to invest the F Fund in a diversified portfolio of securities constructed to track the performance of one of the major bond indexes composed of Government, Federal agency, and corporate bonds.

The adoption of a passive index fund management strategy and the selection of well known market indexes for the C and F Funds satisfied the Board's objective of ensuring that a number of commingled index fund managers with established track records would be available to service the Board in time for the C and F Funds to be operational by the January 1, 1988 statutory deadline. In addition, the broad composition of the C and F Funds, in conjunction with the G Fund, met the Board's policy objective that, taken together, the Plan investment vehicles would provide employees with the opportunity to diversify their portfolios into a broad range of (1) risk-free short-term instruments (the G Fund), (2) equities (the C Fund), and (3) intermediate and long-term debt securities (the F Fund).

The Board established strict minimum standards in its requests for proposals for investment management services for the C and F Funds. To qualify, a privately managed fund had to have at least $250 million in assets in a commingled fund and have been in operation for at least three years. In addition, investment management personnel had to have at least five years' experience and at least $1 billion of tax-exempt assets in all funds under their management. The Board evaluated the investment management proposals for the C and F Funds separately. The investment managers were rated on the basis of their personnel and experience, tracking and trading performance, custodial service, fiduciary record and fees.

In December 1987 the Board awarded two competitive contracts, for both custodial and asset management services for the C and F Funds, to Wells Fargo Bank, a subsidiary of Wells Fargo and Co. Wells Fargo Investment Advisors, another subsidiary of Wells Fargo and Co., provides investment management services to Wells Fargo Bank.

Wells Fargo Investment Advisors is the oldest and largest manager of index funds, with over $62 billion in tax-exempt assets under management. Thrift Savings Plan C Fund assets are invested primarily in the Wells Fargo Equity Index Fund, a commingled S&P 500 stock index fund with almost $14 billion in assets. The Equity Index Fund consists of common stocks of virtually all the companies represented in the S&P 500 index.

The F Fund is invested primarily in Wells Fargo's Bond Index Fund, a commingled Shearson Lehman Hutton Government/Corporate (SLHGC) bond index fund with $858 million in assets. The SLHGC bond index contains approximately 5,000 notes and bonds and was designed to measure the performance of the major bond markets in the United States. The index represents the U.S. Treasury (63 percent), investment-grade corporate (23 percent), and Federally sponsored agency (11 percent) sectors of the fixed income market. The index also includes certain U.S. dollar-denominated securities issued or guaranteed by foreign or international entities in the United States, usually referred to as Yankee bonds (3 percent). Unlike the S&P 500 stock index fund, it is not feasible for the bond index fund to invest in each of the 5,000 securities in the index. Nevertheless, the F Fund is diversified and consists of a large number of securities selected to produce a fund that represents the various types of Treasury, corporate, and agency notes and bonds included in the overall index. Wells Fargo holds about 570 securities in its Bond Index Fund. The average maturity of securities in the index is between 9 and 10 years.

Both the C and F Funds have temporary investments in the G Fund and certain other short-term securities pending the purchase of notes and bonds and for Plan liquidity requirements.

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Investment Returns

For the 12-month period ending June 30, 1989, the net investment returns to participants, after net Plan administrative expenses of approximately .28 percent, were 9.18 percent for the G Fund, 20.85 percent for the C Fund and 12.09 percent for the F Fund. During this period the Wells Fargo Funds closely tracked their respective market indexes. The Wells Equity Index Fund return was 20.60 percent compared to 20.55 percent for the S&P 500 index, and the Wells Bond Index Fund return was 12.43 percent compared to 12.34 percent for the SLHGC index.

As indicated above, net administrative expenses of the Thrift Savings Fund reduced returns by approximately .28 percent for the past 12 months. That means the net reduction in investment return to participants was approximately $2.80 for each $1,000 of their account balance. This expense ratio is expected to decline as the Plan continues to grow. In the calendar year 1988 this expense ratio was .34 percent, and in the calendar year 1989 it is expected to decline to approximately .25 percent

C and F Fund participants bear the investment management costs associated with their Funds, but these costs have been minimal and have been largely offset by the profits C and F Fund investors made on securities lending by the investment manager of the Funds.

Thrift Savings Plan expenses paid by participants are low primarily for three reasons: First, the enabling legislation provides that Agency Automatic (1%) Contributions for FERS employees who leave Government service prior to vesting are to be forfeited and used to defray Plan administrative expenses. Second, Federal agencies provide many of the services to active employees that would otherwise be done at cost to the Plan. Third, the Board, as a Federal agency operating the largest employee savings plan in the Nation, is in an unusually strong position to procure investment and other services at relatively low costs to participants in the Plan.

Proposed Legislation

I will turn now to the proposed legislation submitted by the Board for your consideration. The bill was introduced in the House as H.R. 2514 on May 31, 1989.

Lost Earnings Payments. The bill would provide for payments by employing agencies to the Thrift Savings Fund of lost earnings resulting from employing agency errors. In February 1989, the General Accounting Office (GAO) ruled that the Department of the Interior had no legal authority to use appropriated funds to pay to the Thrift Savings Fund earnings lost due to Interior's late submission of Plan contributions. In its ruling, GAO indicated that it would support legislation authorizing Government agencies to pay to the Fund amounts lost as a result of agency delay in making contributions.

The draft legislation provides specific principles to be applied in correcting certain categories of agency errors. At the same time, the bill provides the Executive Director sufficient flexibility, through regulatory authority, to define other types of errors, to provide additional rules concerning methods of correction, and to permit exceptions from the error correction rules to the extent that corrections are not administratively feasible.

The draft bill permits the Executive Director to require the establishment of a process for decisionmaking and appeals concerning the correction of employing agency errors. The responsibility for adjudicating these cases would be placed upon the agencies themselves, and the agencies would be responsible for setting the specifics of their internal claim procedures, within guidelines established by the Executive Director's regulations. Adjudicatory responsibility at the agency level is necessary, given the Board's duty to act solely in the best interest of the participants and beneficiaries rather than as an impartial arbiter of disputes between an agency and a participant. Also, it is questionable whether all Plan participants should bear the cost of the Board's conducting fact-finding in the arbitration of employer-employee disputes.

We expect that agency errors would in most cases be corrected promptly and without dispute or need for adjudication -- for example, in cases of delayed investments, or investments

in the wrong Fund. In other cases, however, there could be considerable dispute, for example, when employees allege that they were misinformed or when employees were misclassified under the wrong retirement plan, never contributed to the Plan, and then left Government service before the error was discovered.

Under the draft legislation, the participant may seek redress in court if he or she is not satisfied with the resolution of his or her claim at the administrative level. The judicial remedy in the draft bill is consistent with the judicial remedy already provided by FERSA for employees who seek to recover Plan benefits. Before going to court, a participant must exhaust any available administrative remedies.

Removal of Investment Restrictions. The draft bill would also expedite the removal of restrictions on FERS participants' investments in the C and F Funds. As mentioned above, these restrictions require that specified portions of contributions must remain invested in the G Fund over a 10-year period. Under current law, the investment fund restrictions on employee contributions are phased out, in 20 percent increments, over the first five years of the Plan, while the restrictions on agency contributions are similarly phased out over the next five years of the Plan.

The legislative history regarding the purposes of the temporary investment restrictions on FERS employees strongly suggests that such purposes are no longer relevant. According

to the Congressional Research Service, "Many believe it was the intent of Congress to define the deposits into the TSP as an on-budget receipt of the Government, and that the reason for deferring the year in which the TSP funds could be invested in private securities was to minimize outlays." (Issue Brief IB87037, October 3, 1988.) This view is entirely consistent with the Senate Committee Report relating to FERSA which states that the purpose of the phase-in was "to avoid sudden administrative, financial, or budgetary impacts." Senate Comm. on Governmental Affairs 99th Cong., 1st Sess., Federal Retirement Reform Act of 1985 p. 54 (Comm. Report 1985), reprinted in 1986 U.S. Code Cong. & Ad. News, 1459.

However, since the enactment of FERSA, all of the budgetary agencies, including the Congressional Budget Office and the Office of Management and Budget, have concluded that investments in the G Fund should be treated as "non-budget." Thus, all Plan investments, including money moving among the three Funds, have no budgetary impact. This change in budgetary treatment was adopted by Congress and the Administration in 1988. Consequently, there appears to be no remaining justification for the costs to participants of maintaining the investment restrictions.

The result of the current statutory arrangement is that the TSP recordkeeper must keep track of "restricted" and "unrestricted" contributions and earnings in each FERS participant's account, even if it is invested only in the

G Fund. Further, some transactions which affect that account, such as loans, loan repayments, and adjustments must be divided between restricted and unrestricted funds. This substantially increases the difficulty of the ongoing task of designing the recordkeeping system, and also increases the cost of processing individual transactions. The effect is thus an increase in the overall cost of implementing and maintaining the Plan. The distinction between restricted and unrestricted money is also difficult and confusing for TSP participants to understand.

The Employee Thrift Advisory Council, which includes representatives of the organizations representing Federal and Postal employees, has recommended that the Board initiate legislative proposals to accomplish the above purposes.

Mr. Chairman, that concludes my prepared statement. The Board looks forward to working closely with your Subcommittee so that we may best achieve our mutual goal of ensuring that the Plan will be, both in design and operation, the exemplary program that the Congress envisioned. We will continue to make every effort to maintain the enthusiasm, confidence, and trust which have characterized our initial efforts.

I will be happy to answer any questions.

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LIST OF COMPLETED AUDITS, SURVEYS AND REVIEWS
OF THE THRIFT SAVINGS PLAN

1.	Review of Thrift Savings Plan System - Price Waterhouse	3/16/87
2.	Memorandum to Federal Employees' Retirement System Concerning Loan Administration Under the Federal Thrift Savings Plan - Price Waterhouse	10/1/87
3.	Review of Federal Retirement Thrift Investment Board's Accounting Policies, System, Internal Accounting, and Financial Statement Preparation - Conrad & Associates	12/18/87
4.	Audit of Financial Statements of the Thrift Savings Fund as of December 31, 1987 - Arthur Andersen & Co.	6/17/88
5.	Pension and Welfare Benefits Administration Thrift Savings Plan Survey Observations Report - Price Waterhouse	7/27/88
6.	Implementation of the Federal Employees Retirement System - United States General Accounting Office	8/4/88
7.	Pension and Welfare Benefits Administration Review of National Finance Center Access Control and Security Over Thrift Savings Program Resources - Price Waterhouse	8/5/88
8.	Survey Report - Federal Employees Retirement System Thrift Savings Plan to the United States Department of Labor Pension and Welfare Benefits Administration - Peat Marwick Main & Co.	10/7/88
9.	Thrift Savings Fund Financial Statements as of September 30, 1988 Together With Accountants' Review Report - Arthur Andersen & Co.	11/14/88
10.	Federal Employees' Retirement System - Thrift Savings Plan Administrative Review - Coopers & Lybrand	1/9/89
11.	Pension and Welfare Benefits Administration Review of Thrift Savings Plan Withdrawal Subsystem at the National Finance Center - Price Waterhouse	1/17/89

12.	Use of Contractors to Implement the Federal Employees Retirement System - United States General Accounting Office	2/1/89
13.	Pension and Welfare Benefits Administration Review of Thrift Savings Plan Loans Subsystem at the National Finance Center - Price Waterhouse	2/13/89
14.	Pension and Welfare Benefits Administration Review of National Finance Center Computer Operations Management of the Thrift Savings Plan - Price Waterhouse	2/20/89
15.	Audit of the Financial Statements of the Thrift Savings Fund as of December 31, 1988 - Arthur Andersen & Co.	3/17/89
16.	Pension and Welfare Benefits Administration Review of National Finance Center Billing Procedures for the Thrift Savings Plan - Price Waterhouse	3/31/89
17.	Pension and Welfare Benefits Administration Review of National Finance Center Backup, Recovery, and Contingency Planning for the Thrift Savings Plan - Price Waterhouse	4/10/89
18.	Thrift Savings Fund Financial Statements as of March 31, 1989 Together With Accountants' Review Report - Arthur Andersen & Co.	5/12/89

FEDERAL RETIREMENT THRIFT INVESTMENT BOARD
805 Fifteenth Street, NW Washington, DC 20005

September 5, 1989

The Honorable Gary L. Ackerman
Chairman, Subcommittee on
Compensation and Employee Benefits
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Thank you for your letter of August 10, 1989, and the opportunity to respond to questions for the record regarding my July 25, 1989, testimony before the House Subcommittee on Compensation and Employee Benefits. As discussed with Subcommittee staff, in addition to responding to the questions contained in your letter, I will also elaborate on one additional issue which the Subcommittee has indicated it may wish to pursue.

1. QUESTION

The Thrift Board will be soliciting new investment management contracts for both the C and F Funds next year. Is the Board generally pleased with the performance of Wells Fargo Bank?

ANSWER

The Board is extremely pleased with the performance of Wells Fargo Bank/Wells Fargo Investment Advisors in its management of both C and F Fund assets. The C Fund aims to provide participants with the Standard and Poor's 500 (S&P 500) stock index return, while the F Fund's goal is to match returns of the Shearson Lehman Hutton Government/Corporate (SLHGC) bond index. Wells Fargo's Equity Index Fund, the investment vehicle used by the C Fund, returned 16.60% in 1988 versus 16.83% for the S&P 500 index, as measured by Wilshire Associates. In 1989 through July, the Fund returned 27.02% versus 26.93% for the S&P 500 index. The F Fund is invested in Wells Fargo's Bond Index Fund which returned 7.58% in 1988, exactly matching the return on the SLHGC index. The Bond Index Fund returned 11.59% in 1989 through July versus 11.50% for the SLHGC index. Trading costs have been extremely low in both funds. Wells has delivered timely and accurate reports on the Plan's investments and has been extremely responsive to our needs, including working closely with the Department of Labor to accommodate DOL's audit of the Thrift Savings Plan (TSP).

2. QUESTION

Your testimony before the Subcommittee indicates that the administrative expenses of the Plan are expected to be about $2.50 per every $1,000 invested in calendar year 1989. How does this compare to private sector plans?

ANSWER

While we are reasonably assured that the costs of our various functions compare favorably with the costs of private sector 401(k) plans, we have been unable to obtain comprehensive cost data for the private plans. An apparent reason for this is that private plan sponsors generally absorb most or all of their plans' administrative expenses and are thus not required to disclose such costs to their plan participants. Accounting for and allocation of costs may differ substantially among plans. The services offered vary from plan to plan as well. Private plans are also subject to a different set of laws and regulations which can account for some cost differences. If data were available, they would have to be examined very closely to ensure the validity of any comparisons.

3. QUESTION

The Subcommittee is aware that some state and local jurisdictions impose a premium tax on purchases of TSP annuities. Has the Thrift Board considered an exemption from state and local premium taxes similar to the one Congress provided for the purchase of life insurance policies under the Federal Employees Group Life Insurance program?

ANSWER

An exemption from state and local premium taxes similar to the one Congress provided for the purchase of life insurance policies under the Federal Employees Group Life Insurance (FEGLI) program would be in the interests of equity, efficiency, and consistent treatment of Federal employees who participate in the TSP.

There are six jurisdictions which currently impose a premium tax applicable to purchases of TSP annuities. The tax, a flat percentage of the amount paid to purchase the annuity contract applied on

the basis of the participant's residence at the time of the annuity purchase, ranges from one-half of one percent to two percent. Thus, by choosing to receive his or her TSP benefits in the form of an annuity, a participant living in one of the six jurisdictions which imposes the tax is penalized by having his or her account balance reduced by the amount of the tax. If two employees of the same age retired from the Federal Government with identical employment histories and identical account balances, and both elected an identical annuity, the one living in a jurisdiction with an applicable premium tax would get a smaller monthly annuity.

In 1980, Congress exempted from all state and local taxes premiums paid to purchase life insurance policies under the FEGLI program. There is no apparent reason why a similar exemption should not apply to TSP annuity purchases.

4. QUESTION

Various sections of the Federal Employees' Retirement System Act (FERSA) refer to the "annuity commencement date" or "date on which the annuity is to commence" but FERSA does not provide a definition of this date. Does the Thrift Board believe that there should be a distinction between the date on which the annuity is purchased from the annuity vendor and the date on which the annuity payments to the participant actually commence?

ANSWER

Yes. A technical amendment to FERSA would be helpful to clarify the distinction between the date an annuity is purchased and the date an annuity commences.

The Board contracted, as required under FERSA, with an entity which, in the normal course of its business, sells and provides annuities. The common insurance industry usage of the term "annuity commencement date" for an immediate annuity is the date the first monthly payment is due to the annuitant. The Board's Master Annuity Contract limits, to the extent possible, the time between the purchase of the annuity by the Board and the date of first payment by requiring the annuity commencement date to be 30 days after the insurance company receives the gross consideration (i.e., the participant's account balance).

For practical reasons, the date the annuity is purchased and the date the first annuity payment is made cannot be the same date. Thus section 8434(d)(1) which states "At the time the annuity is to commence ... the Executive Director shall expend the balance in the account to purchase an annuity ..." can only be implemented by interpreting "at the time" as a timeframe rather than as a specific date. To avoid the possibility of confusion, the statute should be amended to reflect the reality of the distinction between the purchase date and the commencement date. Similarly, section 8435(d)(2)(B), which creates a responsibility of the Board to enforce court orders up to "the date on which the annuity commences" (i.e., some time after individual account funds have been expended to purchase the participant's annuity), should be amended to make clear that the Board is responsible to enforce court orders only up until the time the annuity is purchased.

I also appreciate the opportunity to comment on a proposal we discussed with your staff to conform certain withdrawal options for TSP participants to the withdrawal provisions available to participants in private sector retirement plans under the Retirement Equity Act of 1984 (REA).

REA amended the Internal Revenue Code to provide that qualified plans could require a participant who separates from service with a nonforfeitable benefit of less than $3,500 to receive, without the consent of either the participant or the participant's spouse, an immediate distribution of the present value of that benefit. There is no provision in FERSA for such expeditious payments of de minimis amounts.

While I do not believe it would be in the interest of TSP participants to require the "involuntary cashout" of de minimis amounts, as authorized by REA, amending FERSA to authorize "automatic cashouts" of de minimis amounts unless the participant selects another option would offer an additional and less cumbersome withdrawal option for many separated employees, as well as reduce the administrative expenses of operating the TSP.

Automatic cashouts would eliminate the need for separated employees with de minimis accounts to arrange for a financial institution to accept a transfer directly from the TSP in order to establish an Individual Retirement Account (IRA). Such a transfer is currently required by FERSA for many separated employees, and this arrangement would not be changed for participants with accounts of $3,500 or more. For those

with accounts below $3,500, the transfer would be optional. Like similarly situated individuals in the private sector, those participants electing to receive the automatic cashout would then have the option of a rollover to an IRA or other eligible plan in order to preserve the tax-deferred status of the retirement benefits.

The proposed amendment would also benefit participants by reducing the Plan's administrative costs. Because FERSA anticipated that the accounts of non-vested separated employees would not remain in the TSP, the Executive Director is required to transfer those accounts to an Individual Retirement Account (IRA) or other eligible retirement plan regardless of the size of the account. By law, this transfer may not occur until the participant provides the Executive Director with the information necessary to identify the institution to which the transfer may be made.

As a consequence, when a separated employee fails to provide this information, the Executive Director is unable to carry out the transfer requirement of FERSA. Over time, many of these separated employees will move without notifying the TSP, and, at some point in the future, if they cannot be located, their accounts will be subject to being declared abandoned. The amendment would allow for the immediate disbursement of small accounts that otherwise might be carried by the Plan until such time as the Board exhausts all the procedures necessary to attempt to locate the participant and declares the account abandoned.

I appreciated the opportunity to appear before your Subcommittee, and am pleased to provide this additional information. If I can be of further assistance to the Subcommittee, please let me know.

Sincerely,

Francis X. Cavanaugh
Executive Director

Mr. ACKERMAN. Thank you very much Mr. Cavanaugh. The committee is aware that the Office of Management and Budget has repeatedly proposed a limitation on the administrative expenses of the Board. Congress, on the other hand, has consistently rejected this limitation. Perhaps you can tell us what the Board's position is with regard to this OMB philosophy.

Mr. CAVANAUGH. Yes, the Board was strongly opposed to the initiative by the Office of Management and Budget which they submitted to the Congress last year and again this year, because that initiative by OMB would subject the Board's administrative expenses to the appropriations process and to OMB control as well.

Briefly, the Board's concern is that under the 1986 act, the Board members and the executive director are fiduciaries, and they are required by that act to act solely in the interest of the participants and the beneficiaries of the plan. OMB, of course, cannot act solely in the interest of the Ps and Bs and, if they have control over the budget, they would have to consider the budget in the context of the total federal deficit and the program of the President. These are not federal funds. It is not government money, and that is why the Congress exempted it from the appropriations process and from OMB. This money belongs to the employees and should be managed just for them. So we have opposed that, and we were very pleased that the Congress rejected the OMB proposal last year and certainly hope it does the same this year.

Mr. ACKERMAN. Could you just give us an idea of the factors that contribute to the level of administrative expenses that the Board incurs each year.

Mr. CAVANAUGH. I did not quite hear, Mr. Chairman.

Mr. ACKERMAN. I am sorry. Give us an idea of the factors that contribute to the expenses.

Mr. CAVANAUGH. Oh, yes sir, the estimated expenses of the Thrift Board in the current fiscal year 1989 are 16.6 million dollars. Approximately half of that amount, a little more than $8 million, is for the principal function of the Board, the recordkeeping function at the National Finance Center in New Orleans.

The next significant item is the salaries and expenses for the personnel of the Board, which amount to about $3.5 million, and the only other large item in the budget is for printing. As mentioned in my testimony, we have already printed and circulated throughout the world about 50 million documents on plan information.

We do those budget estimates the same way as any other federal agency. Then, under this statute, we submit the budget proposal to the Board, the Board approves it, and then we send it to the Congress and to the President, for inclusion in the President's budget but not for review by the President or OMB.

Mr. ACKERMAN. According to the GAO, the Board spent $6.5 million in 1988 on contracts with the National Finance Center in New Orleans. They did this to develop and operate a recordkeeping system. Does the Board have any additional plans for procurements from NFC?

Mr. CAVANAUGH. We do plan, Mr. Chairman, to look to other alternative sources for the recordkeeper, just to assure ourselves that we are getting the recordkeeping services in the most cost effective

way. We have no problems with the National Finance Center. They have been doing a wonderful job. But as soon as the recordkeeping system is complete and they have done all the final documentation, so that one can work up a proper statement of work and request for proposals, our intention is to do a study and find out whether the job could be done better by some other private recordkeeper, just to assure ourselves that we are getting the best value for the money.

We have no reason to believe that somebody else could do it better, but we want to make sure that we are getting the best thing. We probably will not get into that until next year sometime, because the final documentation of the recordkeeping system is not completed.

Mr. ACKERMAN. In your testimony, you state that the Board intends to enclose a special insert in the next participant statement. I presume it is to those who do not participate, asking employees why they are not contributing to the plan. I understand GAO will testify later that they believe the Board should also set up special meetings with agencies that have low participation rates. Is that something you think the Board should be doing now?

Mr. CAVANAUGH. Yes, Mr. Chairman. Actually, on the question of participation, we think the rate is very good. We are accelerating our efforts to communicate with all federal employees, all three million of them, to make sure that they fully understand the benefits of the plan. That is the one activity of the Board that keeps increasing each open season as we put out new brochures and leaflets and posters and various other employee information material.

The participation rate right now—approximately 50 percent of FERS employees who are eligible to contribute are contributing—is very good experience compared to what we know about the private plans. There was a survey done a couple of years ago which indicated that similar private 401(k) plans with over 100,000 employees have an average participation rate of 49 percent. We have already exceeded that. We were just at 49 to 50 percent in the current open season that ends this coming Monday; we would expect the rate to go up somewhat.

So we think we are ahead of similar plan experience, which we find gratifying, because, as you know, FERS employees by definition are employees who were hired only beginning in 1984, so they tend to be young. And my experience with my own children recently out of college is they do not save money; and young people generally, according to the economic statistics, are not big savers. I would expect that the participation rate, because of those demographics, will go up even without significant increased efforts on our part.

But we do plan to continue to increase our effort. In the current open season we tripled, in effect, the communications vehicles. We used to have just one open season booklet. Now we have a plan summary, which gives the whole plan in great detail, a little open season update that people can put in their pocket, and a new poster to make sure people are aware.

So I think we have much left to do, to educate federal employees, but we are very pleased with the experience thus far.

Mr. ACKERMAN. The indemnification of the fiduciaries on the Board—is that to expire at the end of 1990? Will the Board be sending a legislative proposal to the Congress to reauthorize those provisions?

Mr. CAVANAUGH. Yes, Mr. Chairman. I would expect that early next year, in consideration of that December 1990 expiration date, we will be proposing that that not be allowed to expire on December 31, 1990. You are referring to the legislation enacted by the Congress that provided for indemnification, as it were, for the six named fiduciaries, the five members of the Board and myself. The original 1986 act that the Board would go out and buy insurance for the fiduciaries, but the Board found that it could not get adequate insurance.

The most that the market would provide was $50 million, which was not deemed to be adequate for a plan that is already at $4 billion and is expected to go to $40 or $50 billion by the end of the century. So we are very pleased that the Congress put in that amendment in 1988 providing for protection of the fiduciaries against personal financial liability, and we would certainly like to see that extended. The Congress provided a three year sunset on that provision and we would hope that early next year, after two years of experience, although we have yet to have a lawsuit, that we would be prepared to send something up to Congress recommending that that be continued.

Mr. ACKERMAN. Mr. Cavanaugh, H.R. 2514 requires that agencies establish a process for decision-making and appeals regarding the correction of agency errors. Have agencies objected to this requirement as a burden?

Mr. CAVANAUGH. Mr. Chairman, I did not quite hear the end.

Mr. ACKERMAN. Have the agencies objected to the requirement citing that it was an additional burden?

Mr. CAVANAUGH. Oh no. We had meetings many months ago at the President's Council on Management Improvement to expose them to this proposal. Although their responses have been informal, we are not aware of any problems, except that it is going to be an awful lot of work for both the Board and its recordkeeper, the NFC, and the agencies.

But we do not think that there are any serious problems. I sent a copy of the legislation to OMB Director Darman back in April, when I submitted it to the Congress, and invited the views of the Administration. We have not yet heard anything formally, although I must say that our staff has been talking informally with Federal personnel and payroll people in anticipation of this. We do not think that they are going to have any real problem with it, except that it will be a lot of work.

Mr. ACKERMAN. The bill addresses situations in which an employee loses earnings due to an agency error. What about situations where an employee may receive more money than he or she would otherwise have, due to an error on the part of the agency.

Mr. CAVANAUGH. If an error is found, an agency error, and an employee got more money than he should have—say it was inadvertently put in the Stock Fund instead of the Bond Fund and stocks did better—the excess earnings when the error is corrected would go into Thrift Savings Fund, and the net effect of that is

that they would be used to defray administrative expenses and thus increase somewhat the yield to all members of the plan.

Mr. ACKERMAN. The investment of the Fund's money is basically done at this time in the fashion of tracking funds. Has any thought or consideration been given to excluding any companies that the Fund might invest in which do not comply with those standards which are becoming more and more socially acceptable, such as the MacBride principles or the Sullivan principles.

Mr. CAVANAUGH. Well, the answer to your question, Mr. Chairman is that we, in choosing our investments, have just one standard, and that is what is best for the participants and the beneficiaries. That is because of the statutory requirement of the 1986 act that we act solely for the benefit of the participants and the beneficiaries of the plan. Now it has been suggested to us right from day one, when we started this a little over two years ago, that we should be supporting one national policy or other with respect to investing in mortgages to support housing, or to avoid investments in South Africa, and then the bill that you just referred to which has to do with the MacBride principles in Northern Ireland, and it has been suggested to us that we concentrate investments in support of small business and many other seemingly very legitimate purposes. Our problem is, under the existing statute, we are required as I say to act solely in the interest of the Ps and Bs. Congress was very clear, not only in the statute but in the legislative history, that we should not consider any purpose other than the Ps and Bs, because it is voluntary money put in by the participants and it is not government money or federal funds. So we have rejected all proposals that we allocate funds for particular social purposes or that we refuse to invest in various corporations that might be carrying on some program that is regarded as undesirable.

It would require a change in the 1986 act to permit us to do something different to follow social investment policies. If there were such a change it would be a tremendous communication job to Federal employees because, in effect, we presented the plan to them at the outset by saying this is your plan, your money, and there will be no other social or political considerations in investing this money except the employee interest. That is a deal we made. It would be difficult to change that and we could not do it under existing law.

Mr. ACKERMAN. Well, the linchpin here seems to be the phrase, "under existing law." If indeed the 1986 statute was amended in such a fashion so as to preclude investments in those companies, if indeed there are some that are in the Standard and Poor's 500, that engage in or participate in discriminatory acts or practices, do you think that Federal employees would have a problem understanding if we said to them that they had the same "sweet and simple" a deal as your poster proclaims? Would not it be even sweeter if we invested in those companies or did not invest in companies that discriminate?

Mr. CAVANAUGH. Well one thing I would expect, Mr. Chairman, of the 1.4 million participants in our plan, federal employees who already joined it, is that some of them would say, "When you presented this plan to me you said it was my plan, it is voluntary, I put in my own money for retirement, there was one deal and that

is you would act solely in my interest." Now if we are saying we are going to change that to take into consideration one or more social objectives, then they might say, "You have changed the deal, I would like an opportunity to get my money back." Well under our plan, it is a retirement plan——

Mr. ACKERMAN. I do not know that you are changing the deal. The deal is that you are going to invest their money in something safe and secure and if you made it even more American as far as principles and beliefs rather than investment places, I do not know that federal workers, I might be very wrong—I do not know that there are such major companies—but if there was a major company that was in the 500 that was engaging in hatred and bigotry in this country, I think there would be a hue and cry to not have a federal involvement with such a venture.

I noticed in most of the advertising for employment that agencies and corporations do, if they participate in any way with the federal government, it always has "an Equal Opportunity Employer", giving indication that they subscribe to a certain set of beliefs and values and I don't know of anybody that says I do not want to participate in that particular company because I am not getting a bigger bang for my buck because they are hiring too many of these or too many of those.

I do not think that those are the things that we necessarily believe in. And I would venture to guess that if we had a policy of not investing through a federal agency the money of federal employees, and government contributions as well, that there would not be any objection to that; perhaps that would be the positive benefit of having any of those companies which may not subscribe to those kinds of principles and ideals that we all subscribe to, to get them to rethink their positions.

Mr. CAVANAUGH. I am sure that many people would be very supportive of that. I do not know what the attitude of the people in the plan would be. It would be a change in what we presented to them. Since it is retirement money, which means that when they put that money in they can not get it back, it is not like a mutual fund or a bank or some other investment where if you do not like the change in investment policy you can pull your money out. These people are locked in because they get the tax advantages of our plan in consideration of their investing permanently for retirement. So the only way they can get their money out is if they leave the government, and unless they are eligible to retire they have to transfer it to an IRA or similar tax-deferred plan. It is this long run commitment that they had to make, and if one changes the investment policy it is difficult to deal with that argument. Currently, in accordance with law, we are investing the Fund to maximize the employees' return and minimize the administrative expenses. If one were to change that to consider something else, however worthy the objective, then presumably one would expect that the investment return would not be as high, or the administrative expenses would be higher.

Mr. ACKERMAN. One might reasonably expect that the investment return might be the same or it might be even higher if we invested in companies that do not discriminate. I do not know that if we make a presumption that companies that discriminate

against blacks in South Africa or against Catholics in Northern Ireland, are more efficient or produce more capital because of their employment practices. I do not know that anybody would say that. But if we look at it from a practical point of view, logistics which is something I would like to discuss with you, not all of it today.

As I understand it, there are 35 companies within a Standard and Poor 500 that—well there are 35 publicly traded corporations actually that do business in Northern Ireland. Of the 35, 27 are in the Standard and Poor 500 which I believe you invest in almost all of those; of the 500, there is a limited universe of only twenty seven public corporations that this could impact upon at all, most of them of course, all of them major corporations.

We do not know how many, if any, not having looked at this before, may or may not subscribe in this instance to the MacBride principles, hopefully all of them do whether de facto or any other way. It may boil down to one or two companies that do not, and indeed in Northern Ireland might possibly engage in discriminatory hiring practices. Would it create a logistical nightmare if we eliminated those two companies if they did not conform to recognized principles of human rights and behavior?

Mr. CAVANAUGH. Well, apart from the considerations I mentioned Mr. Chairman, we are required by the statute with regard to the Stock Fund to invest in an Index Fund. Our approach was to put out an RFP to get bids from prospective fund managers with very stringent requirements. We required that they had so much under investment, that they had experience managing that particular type of fund for so many years, and so on. It was no problem under the existing statute, because there were a number of S&P 500 fund managers around with a good track record, experience and the sort of thing you would have confidence in, and we got good bidding.

If you depart from that and start getting into specially constructed funds where you eliminate certain corporations for one purpose or another, whether it is Northern Ireland or South Africa or whatever, then you do not have the same kind of experienced track record. That would not be the major problem, except it would be a difficult thing to deal with; of course, as you say, if you are talking about an amendment to the 1986 Act, that would have to be focused on. But I would have to say that the bill itself that you are referring to——

Mr. ACKERMAN. Would it cause a major change if two or three of those companies, let us make a presumption, first that the statute would change so that the argument of the mandate under the statute, for argument's sake for the moment, does not exist. Presumption number two, that there are actually two or three companies within the 27 who refuse to acknowledge—and this is without the benefit of audits or anything else—if there were a requirement that they just assert that they subscribe to those widely held principles. If there are some that, as a matter of fact or principle refuse to assert that they have no discrimination in their hiring practices and they were eliminated, would the change of eliminating any two or three, if there were that many companies from the portfolio make anything of a marked difference in the retirement?

Mr. CAVANAUGH. I would hesitate to put a figure on it, but given our present arrangement, we initially would be talking about an appreciable increase in the cost to the participants in the plan. The reason for that is this; we went out with an RFP and we said in order to manage the investment funds, the Stock Fund for the Thrift Board, the investment manager must have a commingled fund. What that meant was they had to have an S&P 500 fund that included a lot of other people like us, other plans.

We gave the contract to Wells Fargo, they have about 170 different plans in this commingled fund with us. What that means is an extraordinary thing in terms of costs. It means that when we put money into the fund or take it out, they are generally able to trade the securities with other people in the fund because it is commingled, and that eliminates trading costs. Otherwise our trading costs might be something on the order of 20 or 25 basis points instead of just a couple of basis points.

That would mean that the net cost to the participants in the C Fund could be conceivably 50 or 100 percent more than they are now. The big cost in private investment management is the trading cost, and we have virtually eliminated that, because of our being in a commingled fund and because of our potential size. I do not mean that cannot be dealt with. What I mean is it would be very difficult to say to federal employees that a change of the nature contemplated by S. 758, the MacBride Bill, would be of no cost to the federal employees, because of the structural problem.

Mr. ACKERMAN. I think that it bears looking into. If we said that we were going to invest in the Standard and Poor 497, I suppose you have to do the actuarial work, it might just work out. I really have no specific company or two or three in mind whatsoever and hopefully all of them do conform. I do not think that anybody has visited this issue really in depth to this point. It might be that they turn out to be the three weakest as far as return within that fund and any administrative cost in eliminating could be made up by eliminating them.

I do not know that would be true but certainly a possibility. They may be your three strongest, I do not know, which may compound the financial bottom line. But I do intend to pursue this and I do intend to discuss it with you and get your further opinion and evaluation, which I and the subcommittee value, with regard to the MacBride principles to take a look with regard to the Sullivan principles as well.

Mr. CAVANAUGH. I would be happy to work with you, Mr. Chairman on that and give any help that we can provide.

Mr. ACKERMAN. Thank you very much. Ms. Morella.

Ms. MORELLA. You would say that 50 percent of the FERS employees who are eligible are in the plan. What is the percentage of the CSRS employees?

Mr. CAVANAUGH. About 21 percent of CSRS employees have joined; of course they do not get the matching government contribution, and one would expect a lower rate.

Ms. MORELLA. So you do not really push that necessarily; it is just like an IRA or a savings group.

Mr. CAVANAUGH. We have found, Ms. Morella, that the participation by the CSRS employees, even though they do not get a match,

is very good compared to what is known about participation by people in IRAs and in state and local plans that do not have a match. Those participation rates generally have been below 20 percent, and CSRS is already up to 21.

Ms. MORELLA. I wanted to ask you in the few minutes that we have about the agencies' involvements it is a multi-pronged question. For instance I was scanning the GAO report which said something about, I think it is a Navy versus Treasury, Treasury versus State rather in terms of the participation gap being so enormous. And then in your statement you also talked about the fact that you depend very much on the accurate and timely transmission of participant and employer contributions to our recordkeeper. Would you like to comment on whether you are getting full degree of cooperation from the agencies? Would you like to comment on some that perhaps need some more incentive or goading?

Mr. CAVANAUGH. Generally, I think the agencies have been doing a fantastic job, particularly since they had to do so much in such a short time. And the overall participation rate is good, but as I pointed out in the memorandum I sent to the heads of agencies a couple of months ago, there appear to be significant differences with regard to agency administration of the plan; as you mention, some agencies have participation rates down around 30 percent and others are up around 70. We have given the agencies all of this participation data this time. In the spring we broke it down by the sub-units within the agencies, so that the agency heads could look at it and see how they differ not only from other agencies but among the different units within their own agency. And we have offered to help them in any way that we can. Some agencies have better communication programs than others. We do not know whether it is a resource problem with some of the agencies, not having enough personnel, payroll people.

Ms. MORELLA. Did you let them know how well some are doing in using that as an example; how others are not doing quite so well?

Mr. CAVANAUGH. Yes, in sending these reports to the heads of all agencies, we sent summary tables that show very clearly how well some are doing and the fact, by comparison, that others are not doing as well. There are age considerations and salary considerations which affect participation. As I say the younger people do not think as much about retirement as the middle-aged. But there is no question, after you allow for that, there are big differences in the ways some agencies do it.

I mentioned earlier a study of private plans in 1986 that is very dramatic. It shows that participation rates for plans where you have less than 1,000 employees are up around 70 percent. But when you get the plans with over 100,000 employees and, of course, we are many times that, the participation rate goes down to 49 percent. And in between, as you look at the medium size plans, it is a very neat correlation. The bigger the plan, the lower the participation rate.

I assume that is because of, in part, the very difficult communication problems that one has in a big organization. But we are hopeful that with all of our communications with the agencies and the materials that we give them—and we have had 37 meetings with special groups and 100 meetings with other agency groups in

the last couple of years—that we will communicate and train them and help them, and we expect the rates will go up. But there will always be differences.

Ms. MORELLA. Are some agencies—more prone to errors with regard to the resolution that this bill attempts?

Mr. CAVANAUGH. I would say yes. Some of the agencies have the state of the art computer systems for transmitting all the payroll data to our recordkeeper, NFC, in New Orleans. Other agencies have more primitive systems. They are just not as efficient, and their resources vary. So we did find, particularly at the beginning of the plan, that some agencies just could not get their computer tapes in in time. But at this point we do not think that there are serious problems. We think that over the last couple of years the agencies generally have gotten up to speed, although many of them are putting in new computer systems and are going through a transition.

Ms. MORELLA. You know Mr. Cavanaugh, if the Chairman would agree, I would be interested in maybe when you do your next report to see, in terms of implementation of this bill, where the errors are coming from, what the participation is. It would be nice to look at the various agencies. Would you agree Mr. Chairman?

Mr. ACKERMAN. I would agree, no objections. There is a vote. We shall be back within about six minutes. Mr. Cavanaugh, thank you very very much for your testimony. We appreciated the long haitus that you endured and we thank you very very much and we look forward to working with you. We will resume in about six or so minutes with Mr. Bernard Ungar testifying next.

[Recess.]

Mr. ACKERMAN. The subcommittee will come to order; the hearing will continue. The next witness is Mr. Bernard L. Ungar, the Director of the Federal Human Resources Management Issues of the General Government Division of the General Accounting Office. Welcome back again.

STATEMENT OF BERNARD L. UNGAR, DIRECTOR, FEDERAL HUMAN RESOURCES MANAGEMENT ISSUES, GENERAL GOVERNMENT DIVISION, ACCOMPANIED BY THOMAS A. EICKMEYER, ASSISTANT DIRECTOR, GENERAL GOVERNMENT DIVISION, AND ROGER A. HURWITZ, GENERAL COUNSEL, GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE

Mr. UNGAR. On my right is Mr. Thomas Eickmeyer who is an Assistant Director in our General Government Division and responsible for overseeing our work in the FERS area including the Thrift Plan. On my left is Mr. Roger Hurwitz with our office of General Counsel; he is an attorney advisor for our Office of General Counsel and he has worked on some of our issues with respect to the Thrift Plan. We appreciate the opportunity to be here and we appreciate your adjusting the schedules slightly so that we can get back to GAO where we were having some internal meetings today. I would like to summarize my statement and ask that the entire statement be incorporated into the record.

Mr. ACKERMAN. Without objection.

Mr. UNGAR. We support the provisions of H.R. 2514 and these are two major provisions we would like to briefly talk about. We think that the agencies ought to have the authority to pay lost interest that employees may loose out on, based on administrative error that is not their fault. We feel that the agencies currently do not generally have the authority to pay the interest lost due to administrative error and we think as a matter of equity that the agency should have the authority to do so and for that reason we support the Bill.

Also, we support the provision in the Bill that would eliminate the phase-in period for investment in the C and F Funds. We think the reason that the phase-in period was set up initially was because of a budgetary impact. As you know, we have said that we do not feel that the program should be on budget, and others have agreed. It is now off-budget. So the reason for the phase-in period appears to have dissipated. Therefore, we think that it can be eliminated.

One point about the program that you have discussed earlier that we would like to spend a minute on is the participation rates and the variation of the participation rate among employees, among agencies and even among components of agencies. We have noted a wide dispersion of participation and we do think that additional efforts would be helpful by the Board and by the agencies to explain to and inform the employees about the plan and what they may be loosing in terms of their future retirement benefits as a result of not participating.

In the last several months, we have been doing a study of Park Police pay in the Washington area, and one of the observations we made was that there was a less than 30 percent participation rate among the Park Police employees who are eligible to participate. One of the possible reasons for this is, although there are many, that when employees first come on board there is a seven to 12 month waiting period before they can participate in the contributions portion of the program. While agency personnel may inform—and do often inform—the new employees when they walk in the door about their opportunities, by the time seven to 12 months lapse, they may have forgotten some of the benefits and it may not be raised again to them as an issue shortly before they are eligible to contribute.

So one possibility would be to have, in addition to general information, a strategy whereby agencies would target new employees shortly before they are able to participate to again make sure that they are familiar with the plan, the benefits, and the adverse effects of not participating. With that, I would like to conclude my summary and be available for questions.

[The prepared statement of Mr. Ungar follows:]

United States General Accounting Office

Testimony

Statement of
Bernard L. Ungar, Director
Federal Human Resource Management Issues
General Government Division

I am pleased to be here today to discuss H.R. 2514, a bill that proposes to amend the Federal Employees' Retirement System Act of 1986. The bill (1) would authorize federal agencies to pay lost earnings to employees' thrift savings accounts caused by administrative errors of employing agencies and (2) would remove restrictions on investments by certain plan participants. We support these proposals. In addition, we believe agencies and the Thrift Board, which administers the thrift plan, need to do more to encourage employees who are not currently contributing to make the thrift plan part of their retirement income program.

Lost earnings

As of May 1989, about 800,000 employees covered by the Federal Employees Retirement System (FERS) and about 400,000 employees covered by the Civil Service Retirement System (CSRS) had thrift savings accounts. Over 600 payroll offices governmentwide provide the Federal Retirement Thrift Investment Board which administers the plan with millions of transactions annually affecting these accounts. Despite the controls in place at the agencies, administrative errors occur. While the overall number of errors may be relatively small, an error in an individual account, if not corrected early, can significantly affect the retirement benefits of an individual employee.

In December 1987, the Thrift Board implemented regulations to allow correction of administrative errors made by agencies in processing thrift plan transactions. These regulations say the Board will accept agency payments representing interest lost if the agency determines that it has the authority to spend funds for that purpose.

During the past year, we received several inquiries from federal agencies concerning the legality of making payments for lost interest resulting from agency administrative errors. In our February 1989 decision[1] to the Department of the Interior, we held that earnings lost by an employee due to an agency's failure to make timely contributions into an employee's thrift savings plan account are a form of interest not expressly provided for by statute. We concluded that, barring an express mandate by Congress, there is no statutory basis for making such payments to employee accounts from appropriated funds even where the loss was a direct result of an agency error and the employee was blameless. Because this would financially penalize federal employees, we said that from an equitable standpoint, we would support legislation authorizing agencies to make payments into savings plan accounts to cover earnings lost due to an agency's delay in making contributions.

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[1]Agency Authority to Pay Lost Earnings on Contributions to Employee Thrift Savings Plan Accounts, B-231205, Feb. 3, 1989.

Investment restrictions

The Federal Employees Retirement System Act requires all employees covered by the CSRS to invest all thrift funds in nonmarketable securities issued by the U.S. Treasury, called the G fund. Employees covered by FERS were required to invest all employee and employer thrift funds in the G fund through 1987. Beginning in January 1988, however, the act permitted FERS employees to invest a portion of their contributions (and beginning in 1993, a portion of their agencies' contributions) in two additional investment options - a common stock index investment fund (C fund) and a fixed income index investment fund (F fund). All restrictions would be removed by 1997. Section 2 of H.R. 2514 proposes to remove all of the temporary restrictions on investments by participants covered by FERS.

Senate Report 99-166, in discussing the various provisions of the FERS Act, said that the limitation on thrift plan investments during the plan's first 10 years was intended to avoid sudden administrative, financial, or budgetary impacts because the thrift fund was included in the federal budget. In a May 1987 letter[2] concerning the budget treatment of the Thrift Savings Fund, we said the fund's transactions should not be considered transactions of the federal government and, therefore, should not

[2]Letter to Congressman Willis D. Gradison, Jr. (B-227344, May 29, 1987).

be included in the federal budget's total. The Office of Management and Budget agreed with our position and removed the thrift fund from the federal budget in fiscal year 1989. Now that the fund is not included in the budget and its expenditures are not reflected as budget outlays, the restrictions on investments are no longer needed.

Removing restrictions would be beneficial from an employee perspective for several reasons. First, it would reduce confusion concerning the amount of contributions and earnings which may be placed in the C and F funds. Second, the proposal would allow participants to more easily allocate the funds in their accounts among the three plans. Third, it would give employees full control over their investments so they can better meet their personal investment goals.

Participation rates

In addition to our comments on H.R. 2514, I would like to address a challenge still facing agencies and the Thrift Board. While about 800,000 FERS employees have thrift fund accounts because of the automatic 1 percent government contribution, less than 400,000 of these employees are contributing and receiving matching government contributions. Unless the employees who are not contributing can be encouraged to participate, they will find that at the time of retirement their benefits will be significantly less than employees covered by CSRS, and by then it

will be too late to do anything about it. This is because the FERS program was designed to provide benefits comparable to CSRS only when employees fully participate in the savings plan.

The Thrift Board has regularly produced reports identifying participation rates by agency. As of May 1989 (the latest available data), 49 percent of eligible FERS employees contributed to the thrift plan and received matching government contributions. Participation rates among major departments varied from 40 percent at the Department of the Treasury to 70 percent at the Department of State.

The Board expanded the reports in May 1989 to identify participation rates by major components within Departments and we noted significant variances in these rates. For example, within the Department of Navy, component participation rates varied from 26 to 61 percent and within the Department of the Treasury, the participation rates varied from 33 to 73 percent. The Executive Director of the Thrift Board said in a memorandum to the agency heads accompanying this component information that the rates could vary because of significant differences in the way the plan is administered.

One of the factors that may be contributing to the low participation rates is the 7 to 12 month waiting period for newly hired employees before they are eligible to contribute to the

plan. During our current study of U.S. Park Police compensation, we found that only 28 percent of their eligible FERS employees were contributing. Park Police officials said they discuss the thrift plan with new employees at the time they are hired but do not provide any further orientation at the time these employees become eligible to contribute. We believe agencies should target these employees for special briefings to further explain the importance of their participation just before their first opportunity to contribute.

To facilitate the flow of information about the plan to federal agencies, Thrift Board staff have regularly held periodic meetings with department and agency payroll and personnel staff. In addition, at the request of agencies, Thrift Board staff held about 100 meetings with employee groups since the plan began in April 1987. We believe agencies and the Thrift Board should target for special meetings those organizations with low participation rates. Also, they should identify further the reasons why participation rates are low in some organizations and what could be done to address those reasons.

This concludes my statement. I would be pleased to respond to any questions.

Mr. ACKERMAN. Thank you very very much for your testimony and for your summary. Within your testimony you indicated that the agencies should target employees' briefings to further explain the benefits and the importance of participating in the Thrift Savings Plan. Are there any agencies to your knowledge that are taking this action now?

Mr. UNGAR. Mr. Chairman, we are aware of at least one, the Navy Department; I would like Mr. Eickmeyer to go into some detail.

Mr. EICKMEYER. Yes sir, Mr. Chairman. When the Navy received the component information from the Thrift Board in May, they determined that the levels of participation of their employees was too low and something needed to be done. They have subsequently established a goal of 75 percent participation for their employees. In some of their organizations it was as low as 18 to 20 percent. So they have instituted a special counseling program for the components that have low participation rates to go out and talk with their employees.

They have also developed a letter to be sent out to the newly eligible employees who are eligible to contribute to the program, that would go out just two weeks before the eligibility period, to remind them about the program and to further educate them on the benefits that are available to them. And we think that these are the kinds of actions that agencies across the government could be taking to target these kinds of employees.

Mr. ACKERMAN. We are going to anxiously await any indication of the results of that initiative. Mr. Ungar, you further testified that one of the factors contributing to low participation rates could be the seven to 12 month waiting period of the newly hired employees before they are eligible to make contributions. Has GAO identified any other explanations for low participation?

Mr. UNGAR. Mr. Eickmeyer?

Mr. EICKMEYER. I know from my own experience from staff working for me, as Mr. Cavanaugh suggested that younger employees and people in lower pay grades, often are the ones who are not able to contribute. FERS applies to a large extent to the newly hired employees. I have talked with my staff who have become eligible to participate but said they could not afford it, that they needed to reexamine their finances and determine whether or not, for example, at the next pay increase, whether or not they could afford to put a part of their pay raise into the program and most of them have concluded that that was an excellent way that they could start participating in the program by taking and allocating part of the next pay increase to the Thrift Plan.

So even though I can understand and share their concerns about not being able to afford to participate, the other part of it is that they really cannot afford not to participate because it is a major part of their retirement benefits. And if they do not participate when it comes up on time for retirement, some of them will not have enough money to retire on. So they really need to think carefully about participation.

Mr. UNGAR. One other factor, Mr. Chairman, that might be at play here is this general uncertainty among existing employees. It is a new program; of course they are comfortable with the old pro-

gram, and perhaps as time goes on and people become more aware of it and more comfortable with it things could change too.

Mr. ACKERMAN. I thank the three of you for appearing before us today and for your patience. Your complete testimony has been made a part of the record. And you will be back next week?

Mr. UNGAR. Not to my knowledge. Are you having another hearing?

Mr. ACKERMAN. I am getting used to seeing you every week, I was just——

Mr. UNGAR. We will be happy to come if you would like.

Mr. ACKERMAN. Thank you very much. Regrettably, there is another vote in progress; we will stand at ease for another five or six minutes and then resume with President Sombrotto.

[Pause.]

Mr. ACKERMAN. The committee will come to order and the hearing will resume. We are happy to have before us as our next witness Mr. Vincent Sombrotto in his capacity as chairman of the Employee Thrift Advisory Council. Mr. President, thank you very much for the patience that you and the final witness have exhibited and I especially thank you, I know you have endured a long wait at the Senate side today.

STATEMENT OF VINCENT R. SOMBROTTO, PRESIDENT, NATIONAL ASSOCIATION OF LETTER CARRIERS AND CHAIRMAN, EMPLOYEE THRIFT ADVISORY COUNCIL

Mr. SOMBROTTO. Thank you very much Mr. Chairman. In order to help facilitate and expedite this hearing, I will not burden you with reading my whole statement but I will provide it for the record.

Mr. ACKERMAN. Without objection your entire statement will be part of the record.

Mr. SOMBROTTO. I will just make a couple of comments and read just a couple of paragraphs. For example, a concern I have and a concern that is widely shared by my ETAC colleagues is a relatively low level of participation, TSP, by FERS employees. At present, approximately 49 percent of FERS employees contribute their own money to TSP. Mr. Chairman, as you know, FERS employees must consistently contribute to TSP over their careers in the Federal Government, if they are to enjoy a retirement income equal to that of annuitance under the civil service retirement system. Council members may consider asking the Board to market the TSP to FERS employees more aggressively than it currently does to increase FERS employees participation.

I would like to make some comments on some pending legislation before the Congress and I make direct reference to H.R. 2514 which, Mr. Chairman, is being introduced by you. It would amend the FERS Act of 1986, and the TSP as authorizing legislation in two ways that will benefit TSP participants. First, it would give all federal agencies the legal authority to reimburse TSP participants for any earnings they may have lost as a result of an administrative error concerning the Thrift Plan. Second, it would remove all existing limits on how FERS employees may invest their savings among the TSP three investment funds, the G, C and F Funds. I

think that that is very, very important legislation from our standpoint. As the legislation does contemplate, it would correct any errors by reimbursing those employees that would have suffered losses and, of course, in terms of the ability of the Thrift Savings Plan participants, to invest their money in all three funds immediately would be beneficial. As the current system will be phased out by 1997, I do not think it has any relevance. I think that when it was first introduced, it was constructed into the law; it was because of a budgetary consideration. That has not been eradicated so I do not think it has any relevance any more. I would be glad to respond to any questions now.

[The prepared statement of Mr. Sombrotto follows:]

STATEMENT OF VINCENT R. SOMBROTO

Mr. Chairman, my name is Vincent R. Sombrotto, President of the National Association of Letter Carriers (AFL-CIO). The NALC represents over 340,000 active and retired city letter carriers who work and live in every state and jurisdiction of the United States. Today I appear before you in two capacities: as President of the NALC and as Chairman of the Employee Thrift Advisory Council, a body comprised of the leaders of fourteen federal and postal employee unions and associations which collectively represent virtually every federal and postal employee in America.

The Employee Thrift Advisory Council or ETAC advises the Federal Retirement Thrift Investment Board on employee concerns about the Thrift Savings Plan.

Thank you for inviting me to share ETAC's views on the performance of the Thrift Board and on the general operation of the Thrift Savings Plan. I also wish to take this opportunity to convey the Advisory Council's views on legislation related to the Thrift Savings Plan that is now pending before Congress.

Two years ago the Thrift Savings Plan was just getting off the ground. Indeed, the Treasury made its first contribution for the TSP on April 1, 1987. That first contribution of $148 million was the government's automatic 1 percent contribution for the 600,000 FERS employees then on the rolls, retroactive to January 1, 1984. Scarcely two years later, the thrift plan has over 1.4 million participants who have invested nearly $4 billion toward their retirement years, and the TSP is well on its way to becoming the largest plan of its kind in the world. The TSP is operating smoothly, and the Employee Thrift Advisory Council proudly reports that federal and postal employees are generally pleased with the plan.

The Federal Retirement Thrift Investment Board faced a series of daunting tasks in early 1987. It had to set up three investment funds, devise an accounting system capable of handling as many as 3 million accounts, and coordinate the activities of 600 different federal government personnel officers to insure that employees understood their options under the plan and were able to invest in it with ease. In some cases the Board had less than six months to accomplish these tasks. Nevertheless, the Board was exceptionally successful in achieving the goals set before it by Congress. I wish to commend the members of the Board as well as the Board's Executive Director Frank Cavanaugh, his Staff Director of External Affairs, Tom Trabucco, and their staff for the excellent work they have done over the past 2½ years.

The Employee Thrift Advisory Council has held eight meetings since April 1987. As you might expect, much of our early discussions with (and advice to) the Board concerned start-up issues—such as how best to educate millions of federal and postal employees about the plan, how best to encourage participation, and the proper content of regulations to get the TSP up and running. Subsequently, the Council worked with the Board and Congress to enact a number of technical amendments to the Federal Employees Retirement System Act of 1986 to benefit TSP participants and reviewed the Board's procurement of investment fund managers. In our most recent meetings, we have turned to discussions of the Board's investment policies in each of the TSP three investment funds which have met with the Council's general approval. In all our meetings, the Board has been forthcoming and open to our recommendations.

Thus far, the Council and the Board have been in general agreement on virtually all matters, a fact that is not surprising given the common interest we have had in getting the Thrift Savings Plan off to a successful start. Now that the TSP is functioning well, the kinds of issues we will face in the future may be different, and the Board and the Council may not always see eye to eye.

For example, a concern I have—and a concern that is widely shared by my ETAC colleagues—is the relatively low level of participation in the TSP by FERS employees. At present approximately 44 percent of FERS employees contribute their own money to the TSP. Mr. Chairman, as you know, FERS employees must consistently contribute to the TSP over their careers in the federal government if they are to enjoy a retirement income equal to that of annuitants under the Civil Service Retirement System. Council members may consider asking the Board to market the TSP FERS employees more aggressively than it currently does to increase FERS employee participation.

In general, however, I believe the Council and the Board have an amiable and constructive working relationship, and I am confident that we will continue to work together to serve the postal and federal employees who participate in the TSP and who will rely on it as a vital part of their retirement security.

I would now like to briefly comment on a piece of legislation affecting the TSP that is now pending before the Congress.

The legislation to which I refer is H.R. 2514. This bill, which was introduced by Chairman Ackerman on May 31, would amend the Federal Employees Retirement System Act of 1986, the TSP's authorizing legislation, in two ways that will benefit TSP participants. First, it would give all federal agencies the legal authority to reimburse TSP participants for any earnings they might lose as a result of an administrative error concerning the thrift plan. Second, it would remove all existing limits on how FERS employees may invest their savings among the TSP's three investment fund—the G, C, and F Funds.

On rare occasions, agency payroll offices make mistakes with regard to employees' participation in the Thrift Savings Plan. These mistakes are usually discovered, but some may go undetected despite our system checks. When they are discovered, agencies can act to correct them, but usually are not authorized to reimburse employees for any lost earnings that may have resulted from the error. However, the reimbursement of such lost earnings and the legal authority to do so is crucial if employees are to maintain confidence in the system, be treated fairly, and be made "whole" for the financial injury they suffer as a result of agency errors. Although I am certain that the Postal Service has the authority to reimburse lost earnings, in cases of administrative error, most agencies do not.

Take, for example, the Interior Department, a department that the GAO has specifically determined does not have the legal authority to reimburse lost earnings that might arise from an error. Consider the following scenario. An Interior Department employee properly instructs her employing agency to invest 40 percent of her TSP contributions in the Common Stock or C Fund and 60 percent of them in the Government Securities or G Fund. Instead, the agency invests 100 percent of her contributions in the G Fund. The agency discovers its error a year later. If the interest earned on C Fund investments exceeds that earned by G Fund investments, the employee will have lost money as a result of the error. Under current law, the Interior Department cannot reimburse the employee for these lost earnings. The first part of H.R. 2514 will prevent this injustice from happening.

The other main provision of H.R. 2514 would remove the existing limits on how TSP participants covered by FERS can allocate their savings among the thrift plan's three investment funds. These limits, which are to be phased out by 1997 under current law anyway, serve no useful purpose and raise the cost of administering the TSP—thereby lowering the earnings of all TSP participants.

In 1989, for example, FERS employees may only invest 40 percent of their contributions outside of the G Fund and none of the contributions made by the employees' agencies can be invested in the C and F Funds. Over the next three years, the limits on how FERS employee contributions may be invested will be phased out while restrictions on how agency contributions may be allocated among the TSP's three funds will be phased out between 1993 and 1997. Clearly these limits serve to restrict participants' options and under some circumstances lowers the overall return they otherwise earn on their investments. This is the case because stocks and bonds—the investments made available by the C and F Funds—have historically provided higher returns than government securities.

Congress imposed the limits on how FERS contributions could be invested for budgetary reasons. At the time the Federal Employees Retirement System Act of 1986 became law, purchases of the government securities in which the G Fund is invested were considered revenues to the Treasury. This meant that the government's automatic and matching contributions for FERS employees that were invested in the G Fund were not treated as current expenditures and that employee contributions of their own money to the G Fund were treated like tax revenues. Thus, funneling TSP contributions to the G Fund and limiting the amount of such contri-

butions that could be invested in the C and F Funds served to reduce the federal budget deficit. Subsequently, this treatment of TSP contributions in the federal budget was abandoned. Thus, the rationale for limiting the investment options of FERS TSP participants no longer exists.

The limits on how FERS employees may invest their contributions not only serve no rationale purpose, the administrative burden of keeping track of the principal and earnings of restructed and unrestricted TSP funds also raises the overall cost of running the TSP, and, therefore reduces the returns of all TSP participants, those covered by FERS and CSRS alike. This is the case because the Federal Retirement Thrift Investment Board is required to pay for the cost of running the TSP primarily from forfeitures and secondarily out of the earnings of the plan's three funds. For these reasons, we believe the limits should be removed.

I therefore urge this subcommittee to recommend passage of H.R. 2514.

Mr. Chairman, thank you again for this opportunity to express my views concernings the Thrift Savings Plan. I will be glad to answer any questions from you or the members of your sub-committee.

Mr. ACKERMAN. Thank you very much. A recurring theme that is running through the testimony today is a concern about the level of participation by FERS employees. We know that the employee organizations have been actively encouraging employees to participate. Could you give us some specifics of what employee groups have been doing.

Mr. SOMBROTTO. In our case, I can speak to my own organization, I think it reflects what most of the others are doing, and that is in our own internal publications we keep writing periodically about the wisdom and the propriety of investing in the Thrift Savings Plan for those that are covered under FERS particularly because it will be important to their future retirement.

I think that is about as much as we can do under the present system. Of course, we have been trying to encourage the Thrift Savings Board to engage in some kind of a more aggressive marketing of the Thrift Savings Plan but they have been reluctant to do so. They feel that they are restrained by some statutes.

Mr. ACKERMAN. GAO believes that agencies and the Board should set up special meetings with organizations with low participation rates and try to identify the reasons why the participation is low. Do you think the Board should pursue that type of course or should the individual agencies be doing more?

Mr. SOMBROTTO. Well I think that both pursuits would get better results. I think that if we went on both tracks we might get a better result. If we were limited to one or the other, I do not know that there would be an exclusion to one or the other, I think that if that were the case the individual agencies would be closer to the people themselves. And that might have a better result.

Mr. ACKERMAN. I pursued a line of questioning earlier today with Mr. Cavanaugh of the Thrift Investment Board, concerning the possible exclusion of investment opportunities in those corporations that participated in discriminatory practices in so far as hiring. We were talking specifically about the MacBride principles and tangentially about the Sullivan principles, respectively, in Northern Ireland and South Africa. Do you have any particular point of view on that at this time?

Mr. SOMBROTTO. Well, interestingly enough at our last ETAC meeting, the question did come up and it was pointed out that the individual organizations such as my own stand very strong for those principles, both MacBride and Sullivan. In fact, any set of

principles which would mitigate against those societies or those countries that practice discrimination in any form are places we do not want to invest our money. We have made it a policy in my union not to invest our funds in those kinds of societies.

We have a problem with the Thrift Savings Plan. As you know, it was structured in the law to be politically neutral. We did discuss this in depth, I might add, as we looked at the legislation being offered by Senator Lautenburg, and it creates some problems in that it would require some participation by shareholders. In that there would be aggressive shareholder participation where Thrift Savings Plan is not a shareholder type of situation where the money is invested for those that have invested their monies in Index Funds. They are not shareholders per se.

Mr. ACKERMAN. One of the things that we were looking at pursuing is the possibility of—it was not to preclude investment in those companies that have investments in those areas where there may be problems. But rather, if the companies themselves who may be in the Index, if indeed there are any, if those companies themselves participated in discriminatory practices in hiring, to modify the Index in some fashion by just not investing in the stocks of those particular companies. The intent not necessarily being punitive, but to allow them to see the wisdom of conforming to the principles of non-discrimination.

Mr. SOMBROTTO. Well, that is an interesting concept. If I understand it, what you are saying is that if we are in an Index that has 500 components and six of those companies were investing in, were directly involved in discriminatory practices, that we would require our investment counselor, investment advisors to withdraw those six out of the Index itself. That is something we may take up at our next ETAC meeting.

Mr. ACKERMAN. And possibly rather than construct a new Index by adding six others just to divide it proportionately.

Mr. SOMBROTTO. Well, that is an interesting concept. We had not thought of it in that respect.

Mr. ACKERMAN. Well, I offer that to you as food for thought in an area that I intend to pursue. I would like the opportunity to discuss it with you and with those that you represent on the advisory council.

Mr. SOMBROTTO. That could be useful; I would have to play that back when we have our next meeting. And of course, Director Cavanaugh who was here earlier, he will be aware of this colloquy here and I am sure he will have some response to it. Let me for the record state, individually and from an organizational standpoint, the National Association of Letter Carriers stands very strong behind those principles of being against those companies and not investing in those companies that engage in discriminatory practices whether it is race, religion, sex or whatever.

Mr. ACKERMAN. Your organization always is in the forefront and the cutting edge of avante garde social policy.

Mr. SOMBROTTO. Cutting edge, that is the new term.

Mr. ACKERMAN. We are required to say that at least once. [Laughter.]

Mr. Sombrotto, thank you very very much.

Mr. SOMBROTTO. Thank you, it was a pleasure to be before you.

Mr. ACKERMAN. The award for patience today goes to our next witness, Mr. Ian Dingwall, the Chief Accountant, Pension and Welfare Benefits Administration, Department of Labor. Thank you very much for your tolerance of our very erratic schedule today. Welcome to the subcommittee and you may begin at your leisure.

STATEMENT OF IAN DINGWALL, CHIEF ACCOUNTANT, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. DINGWALL. Thank you very much Mr. Chairman. In the interest of brevity, I would also like to have my statement become part of the record. I would like to go on if I could.

Mr. ACKERMAN. Without objection, your entire statement will be submitted as part of the official record and you may summarize as you please.

Mr. DINGWALL. Fine. First let me say that I am very pleased to be here before you to describe our activities under the Federal Employees Retirement System Act of 1986, which we call FERSA. That act requires the Secretary of Labor to enforce the fiduciary responsibility of bonding provisions of the act. The department has committed very substantial resources to enforcing FERS' fiduciary provisions. We have written many regulations consistent with the Secretary of Labor's oversight responsibilities under the act. And, in addition, we have at the department implemented a very comprehensive system of compliance audits which are essentially designed to determine the level of compliance with the provisions of the act.

By the end of this fiscal year, we will have about 25 compliance audits, either in draft or in final form. To carry out this audit activity, we have established in my office the division of FERSA compliance. These compliance audits, which are performed under contract by independent public accounting firms, have enabled the department to develop and implement a strategic audit approach which utilizes detailed compliance modules. These audit modules facilitate the review of plan activities with respect to the Thrift Investment Board, the fund's investment manager, as well as the recordkeeping functions now performed by the U.S. Department of Agriculture's National Finance Center. And, we also monitor employee participations by agency, payroll and personnel offices.

The Department is also implementing advanced computerized auditing techniques, for example, the Thrift Savings Plan maintains a data file on its 1.4 million participants. This file contains a record of virtually every plan transaction that effects participants' accounts. We have at the Department of Labor identified and developed a system for periodic sampling and review of the data which is drawn from the TSP master file. These reviews provide for the independent analysis of planned data on a quarterly basis.

Finally, the division of FERSA compliance has completed onsight reviews of various service providers for the Thrift Savings Fund. These reviews have included visits to the U.S. Department of Treasury, the Metropolitan Life Insurance Company, and to Wells Fargo Bank with respect to the C and the F Index Funds. The results of our reviews have been very encouraging. The Thrift Sav-

ings Plan is accurately and efficiently processing data with respect to plan transactions. Employing agencies' personnel devoted to FERSA processing appear to be well-qualified and generally knowledgeable about FERSA. And in view of the generally high participation rates that the Thrift Savings Plan enjoys, we believe that the Board has generally effectively communicated the merits of the Thrift Savings Plan program to the Federal work force.

We will continue to monitor the participation in these funds as part of our on-going responsibilities. Let me assure you that the Department of Labor is dedicated to maintaining the security of the Thrift Savings Fund and to ensuring that these funds are prudently managed for the exclusive benefit and solely in the interest of participants and their beneficiaries. We look forward to working with the members of this subcommittee as well as the members of the Federal Retirement Thrift Investment Board in this endeavor. This concludes my remarks. Again, thank you for the opportunity to testify before you today regarding this important matter. I would be happy to answer any questions that you may have.

[The prepared statement of Mr. Dingwall follows:]

STATEMENT OF IAN DINGWALL
CHIEF ACCOUNTANT
PENSION AND WELFARE BENEFITS ADMINISTRATION
U.S. DEPARTMENT OF LABOR
BEFORE THE
SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS
COMMITTEE ON POST OFFICE AND CIVIL SERVICE

July 25, 1989

Mr. Chairman and Members of the Subcommittee, my name is Ian Dingwall. I am the Chief Accountant for the Pension and Welfare Benefits Administration, U.S. Department of Labor.

I am pleased to appear before you to describe our activities under the Federal Employees Retirement Systems Act of 1986 (FERSA) which requires the Secretary of Labor to enforce the fiduciary responsibility and bonding provisions of the Act.

Before I address any specific questions you may have regarding FERSA's fiduciary responsibility and bonding provisions, I would like to provide you with some background information.

As you know, FERSA created a tax-deferred savings plan, known as the Thrift Savings Plan. Employer and employee contributions to the Plan are remitted to the Thrift Savings Plan by employing agencies of the United States Government. These contributions are in turn invested in one or more of three separate investment funds which together comprise the investment vehicles for the Thrift Savings Plan.

To insure the integrity of the Plan, FERSA establishes strict fiduciary, prohibited transactions, and bonding requirements. These requirements are intended to guarantee that fiduciary actions are taken solely in the interest of participants and beneficiaries. They are patterned after those of the Employee Retirement Income Security Act of 1974 (ERISA) which governs employee pension and welfare plans in the private sector. The Secretary of Labor, who administers these requirements of ERISA, has been assigned the responsibility of enforcing FERSA's fiduciary and bonding provisions. In addition, FERSA requires the Secretary to promulgate a number of implementing regulations relating to the enforcement and fiduciary provisions of the Act.

The Department has committed significant time and resources to enforcing FERSA's fiduciary provisions. Regulations have been promulgated to assist the Secretary with her oversight responsibilities under the Act. In addition, the Department has implemented a comprehensive program of compliance audits to provide strict adherence with the provisions of FERSA.

With respect to FERSA's fiduciary provisions, the Department has adopted, for purposes of the prohibited transaction provisions, certain class exemptions previously granted under ERISA. These class exemptions allow the Plan to engage in certain

necessary transactions that could otherwise fall within the scope of FERSA's prohibited transaction provisions, provided the protective conditions of the exemptions are satisfied. These class exemptions were published prior to the statutory deadline of December 31, 1988.

To safeguard the Plan against loss due to fiduciary misconduct, the Department has promulgated regulations which create detailed procedures for the allocation of fiduciary responsibility. The regulations also create procedures for the allocation of fiduciary responsibility to qualified professional asset managers and investment managers. The regulations allocating fiduciary responsibility were published prior to the statutory deadline of December 31, 1988.

Under the 1986 FERSA Technical Corrections Act, the Secretary was required to issue regulations with respect to FERSA's bonding provisions by December 31, 1989. FERSA's bonding provisions generally require that each fiduciary and each person who handles funds or other property of the Fund be bonded against loss by reason of fraud or dishonesty. Interim rules which adopted ERISA bonding regulations for FERSA purposes were published on September 23, 1987. The Department's final bonding regulations are currently under review and we anticipate they will be published in the Federal Register prior to the statutory deadline.

Congress also granted the Secretary the authority to assess civil penalties against "parties in interest" who engage in prohibited transactions with the Plan. The Department has proposed these regulations on September 26, 1988. We expect to publish final regulations in the Federal Register shortly. Publication of the final civil penalties and bonding regulations will complete our statutorily required obligation to publish regulations under FERSA.

In addition to these regulatory efforts, the Department has implemented an extensive program of audits with respect to the Thrift Savings Plan. This program has included a broad range of on-site compliance audits. To carry out this function we have established within my office, the Division of FERSA Compliance.

These compliance audits, performed under contract by independent public accounting firms, have enabled the Department to develop and implement a strategic audit approach which utilizes detailed compliance audit guides. These audit guides facilitate the review of Plan activities with respect to the Thrift Investment Board, the Fund's investment manager, as well as the recordkeeping functions performed by the U. S. Department of Agriculture's National Finance Center, and employee participation at the agency payroll and personnel offices.

The Department is also implementing advanced computerized auditing techniques. For example, the Thrift Savings Plan maintains a data file on its 1.4 million participants. This file contains a record of each plan transaction. The Department is developing a system for the periodic sampling and review of data drawn from the TSP Master File. These reviews will provide for the independent analysis of plan data on a quarterly basis.

Finally, the Division of FERSA Compliance has completed on-site reviews of service providers for the Thrift Savings Fund. These reviews have included the U.S. Department of Treasury ("G" Fund), Metropolitan Life Insurance Company, with respect to annuity contracts, and the Wells Fargo Bank, with respect to "C" and "F" (Index) Funds.

The results of our reviews have been encouraging. The Thrift Savings Plan is accurately and efficiently processing data with respect to plan transactions. Employing agencies personnel devoted to FERSA processing appear to be qualified and generally knowledgeable about FERSA. In view of the generally high participation rate in the Thrift Fund, we believe that the Board has effectively communicated the merits of the Thrift Savings Plan program to the Federal workforce. We will continue to monitor the progress of the funds as part of our ongoing responsibility.

The Department of Labor is dedicated to maintaining the security of the Thrift Savings Fund and to ensuring that these funds are prudently managed for the exclusive benefit and solely in the interest of participants and their beneficiaries. We look forward to working with the members of this Subcommittee as well as the members of the Federal Retirement Thrift Investment Board in this endeavor.

Mr. ACKERMAN. Thank you very much Mr. Dingwall. In your testimony you state that the Department of Labor has implemented an extensive program of audits with respect to the Thrift Savings Plan. Have these audits led to any specific recommendations regarding the operation of the Board?

Mr. DINGWALL. Yes. To date we have probably made about 125 recommendations which would impact on the operations of either the Board or service providers to the Board.

Mr. ACKERMAN. What type of recommendations were they? Not all 125.

Mr. DINGWALL. The recommendations essentially go to improvements, things that would improve the efficiency and operation of the aspects of the fund.

Mr. ACKERMAN. Your testimony also states that you have recently completed an on-sight review of service providers for the Thrift Savings Plan including the review of the Wells Fargo Bank. Would you characterize Wells Fargo as doing a good job, a reasonable job?

Mr. DINGWALL. Yes. Wells Fargo, from our vantage, a very well run organization. We take very seriously the operations of both of the Index Funds. Thery are extremely well audited not only by us but by other federal organizations. They have internal audit staffs and they also have sets of outside independent auditors who come in and review their operations.

Mr. ACKERMAN. Do you think that the fact that they won both bids for both funds independently accrued to the benefit of the participants?

Mr. DINGWALL. You mean as opposed to having one asset manager for one fund versus the other?

Mr. ACKERMAN. Yes. I asked the question in the context of, in light of the fact that these both will be re-bid at the end of next year I believe. Should they be packaged and bid together or——

Mr. DINGWALL. Well, they were never packaged and put together before. They are actually separate procurement actions. It happened that Wells Fargo won both, if I am not mistaken.

Mr. ACKERMAN. I understand, but the heart of the question goes, is there a benefit that can be seen in their having won both?

Mr. DINGWALL. Frankly I do not know the answer to that. I would suspect that it is obviously easier to deal with one organization than two but beyond that I do not know if there is anything that I can quantify for you.

Mr. ACKERMAN. Thank you very much. There being no further witnesses the hearing stands adjourned.

[Whereupon, at 1:50 p.m., the subcommitte adjourned.]

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